

Polish Banks

Macro Affecting Micro – Staying Negative on Polish Banks

- **3Q12 Earnings Down 3% yoy** — Net profit of our universe of large and medium size Polish banks (excluding BGZ) declined 3% yoy, negatively affected by 4% yoy lower net fee and 17% yoy higher provisioning while net interest income and administrative costs were flat yoy.
- **1.3%p + (-150bp) + (-50bp) – (+10bp) – (+50bp) = -20%** — The maths look strange but we expect slowdown in macro (to 1.3% GDP growth) combined with an expected 150bp cut in interest rates, 50bp reduction in interchange fee (to c.1.1% from 1.6% now), c10bp increase in contribution to the Bank Guarantee Fund and on average 50bp increase in cost of risk to lead to 20% yoy lower net profit for our universe of eight Polish banks.
- **Downgrading PKO BP and Pekao** — Due to lowered assumptions of sustainable ROE (driven predominantly by lower rates), we downgrade PKO BP (TP ZI 38.1 vs. ZI 40.7 previously) to Neutral from Buy and Pekao (TP ZI 148 from ZI 152) to Sell from Neutral (among Polish financial stocks with high dividend yields, we prefer Neutral-rated PZU to Pekao). We also change our ratings on two other banks: for Getin Noble Bank (TP ZI 1.81 from ZI 1.82) to Neutral/High Risk from Neutral (due to high dependence of the bank's earnings on revenues from insurance fees, which could be negatively impacted by announced recommendations on bancassurance) and for Kredyt Bank (TP ZI 18.5 from ZI 18.3) to Buy from Buy/High Risk (due to reduced risk, in our opinion, that the merger with BZ WBK will not be approved by the regulator).
- **Buy BZ WBK and Kredyt Bank** — Kredyt Bank (Buy, TP ZI 18.50 from ZI 18.30) and BZ WBK (maintained Buy, TP ZI 266 from ZI 263) are now our only Buy-rated banks in Poland. We think that the prepared merger of these banks will allow them, through building scale, to partly offset the macro headwinds. We maintain Sell ratings on BRE (TP 279 from ZI 273) and Millennium (TP 3.7 from ZI 3.85) and a Neutral rating on ING BSK (TP ZI 92.0 from ZI 88.2).
- **Expensive vs. GEM Peers** — On our 2013E forecasts Polish banks look expensive vs. GEM peers (see Fig. 7-9 for details).

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Company	Ticker	Rating		Target Price		Current Year Earnings Estimates	
		Old	New	Old	New	Old	New
BRE	BREP.WA	3	3	ZL273.00	ZL279.00	ZL26.67	ZL27.31
ING Bank Slaski	BSK.WA	2	2	ZL88.20	ZL92.00	ZL6.19	ZL6.46
Bank Zachodni	BZW.WA	1	1	ZL263.00	ZL266.00	ZL17.66	ZL18.18
Getin Noble	GNB.WA	2	2H	ZL1.82	ZL1.81	ZL0.15	ZL0.14
Kredyt Bank	KRB.WA	1H	1	ZL18.30	ZL18.50	ZL0.78	ZL1.15
Bank Millennium	MILP.WA	3	3	ZL3.85	ZL3.70	ZL0.35	ZL0.37
Bank Pekao	PEO.WA	2	3	ZL152.00	ZL148.00	ZL10.62	ZL11.34
PKO BP	PKO.WA	1	2	ZL40.70	ZL38.10	ZL3.01	ZL3.02

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

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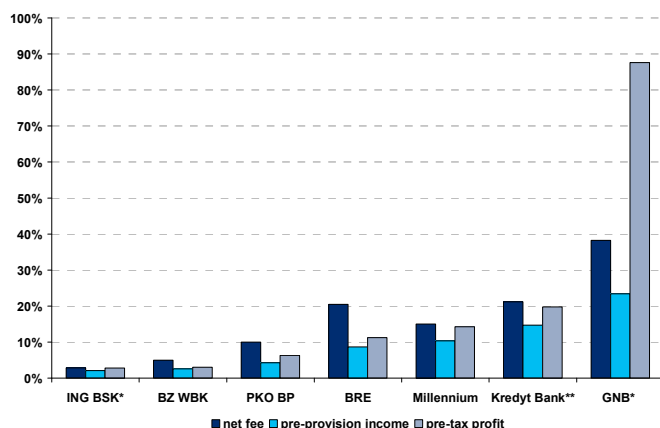
Macro Affecting Micro

Polish banks appear as pessimistic now as at almost any time in recent memory. True, they are not as scared as they were at the end of 2008, when they positioned themselves to struggle to survive in completely changed environment (weakened Zloty, negatively affecting the funding and capital positions of banks strongly engaged in FX mortgages; the sudden halt to external funding; and a rapid deterioration in asset quality, additionally impacted by unpaid corporate client liabilities from FX options). Increased capital (through profit retention and share issuance), improved liquidity and enhanced risk management allow bankers to feel more comfortable now about stability of their institutions, but due to the macro headwinds (lower demand for products, lower rates and higher provisioning) they don't see any tools to offset the negative impact of regulatory intervention (a prepared cap on interchange fees and a bank levy) and are guiding to lower earnings in 2013.

There is another regulatory risk: a pre-announced recommendation on good practices in selling insurance products by banks - we do not expect a similar hit to banks' profitability as in case of PPI in the UK, but some banks specializing in consumer banks (among our coverage namely Getin Noble Bank) may suffer.

We continue also to investigate the impact of pre-crisis FX mortgage loans on banks' performance: according to our estimates, excluding the impact of these low-margin loans, the ROEs of some banks heavily exposed to FX mortgages (e.g. Millennium, Kredyt Bank and Getin Noble Bank) would be in the range of 15-19% vs. actual levels of c10%.

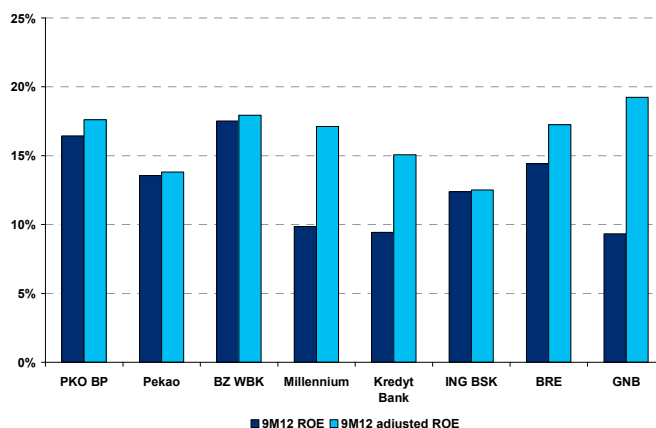
Figure 1. Polish Banks – Fee from Sale of Insurance as % of Net Fee, Pre-Provision income and Pre-Tax, 9M12 (Percentage)



Note: * excluding investment products wrapped as insurance ** 1H12

Source: Company reports, Citi Research

Figure 2. Polish Banks – Actual ROE vs. ROE on Business Excluding FX Mortgages, 9M12 (Percentage)



Source: Company reports, Citi Research

Only Two Buys Left

Lower Rates Weigh on Estimates and Valuations

Taking into account lower long-term rates (yields on Polish 10-year government bonds have dropped to c4.1% from c6% at the beginning of 2012), we have decided to lower our cost of equity assumption by 50bp for each bank. Hence we now use 10.0% for banks with low exposure to FX mortgages, 10.5% for those with medium exposure and 11.0% for those heavily engaged in FX mortgage business (vs. 10.5%, 11.0% and 11.5%, respectively, previously).

Figure 3. Polish Banks – Sensitivity of WEV to COE (Polish Zloty)

	PKO BP	Pekao	Pekao v 2	BZ WBK	Millennium	Kredyt Bank	ING BSK	BRE	GNB
9.0%	47	164	197	299	5.3	10.1	113	373	2.67
9.5%	42	148	181	269	4.8	9.0	101	335	2.39
10.0%	38	135	167	245	4.3	8.2	92	305	2.16
10.5%	35	124	156	224	4.0	7.5	84	279	1.97
11.0%	32	114	147	207	3.7	6.8	77	257	1.81
11.5%	30	106	138	192	3.4	6.3	72	239	1.67
12.0%	28	99	131	179	3.2	5.9	67	223	1.55
12.5%	26	93	125	168	3.0	5.5	63	209	1.45

Source: Citi Research estimates

Figure 4. Polish Banks – Sensitivity of Potential Valuation Upside to COE (Polish Zloty)

	PKO BP	Pekao	Pekao v 2	BZ WBK	Millennium	Kredyt Bank	ING BSK	BRE	GNB
9.0%	33%	5%	26%	25%	26%	-35%	27%	19%	65%
9.5%	20%	-5%	16%	13%	13%	-42%	14%	7%	47%
10.0%	9%	-14%	7%	3%	2%	-47%	3%	-2%	33%
10.5%	-1%	-21%	0%	-6%	-6%	-52%	-5%	-11%	22%
11.0%	-8%	-27%	-6%	-13%	-13%	-56%	-13%	-18%	12%
11.5%	-15%	-32%	-11%	-19%	-20%	-59%	-19%	-23%	3%
12.0%	-21%	-37%	-16%	-25%	-26%	-62%	-25%	-29%	-4%
12.5%	-26%	-41%	-20%	-30%	-30%	-65%	-29%	-33%	-10%

Source: Citi Research estimates

However, we need to keep in mind that lower rates not only impact valuation – first of all they impact banks' profitability. The impact on results in the short term depends on the pace of asset and liability re-pricing. Broadly speaking, savings accounts re-price first (nearly immediately), followed by mortgages and corporate loans linked to Wibor (with about one quarter's delay vs. changes in Wibor) and 3- and 6-month deposits (re-priced during roll-over). For consumer loans, the type of loan and level of interest rate (sometimes cuts are triggered by regulation of the maximum interest rate) will determine the pace of repricing. Assets with interest rates fixed for longer include government bonds (but banks cashing gains through selling bonds may consume these profits at once and have to replace them with lower-yielding securities). On the deposit side, issued debt may have a fixed or float rate. In any case, within one to two years, a bank will have re-priced all assets and liabilities excluding current accounts with zero rate and own equity.

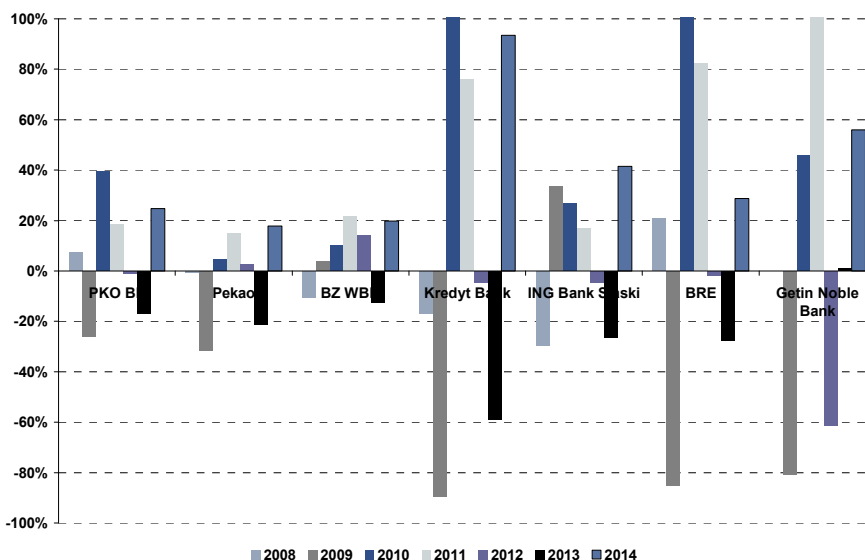
Lowered interest rate forecasts (to 3.25% at the end of 2013 vs. 3.75% expected previously) and the currently existing inverted rate curve (yields on long-term bonds are lower than Wibor 3M) are the main reasons why we reduce our earnings estimates. Another factor negatively affecting our forecasts is lowered fee projections. We see little chance of a material rebound in investment fund fees (given current investor risk aversion and relatively weak performance from equities, we expect potential inflows to investment funds to continue to go to low-margin bond funds rather than to high-margin equities products). The trend of declining account and transactional fees is not abating. Fee income in 2013E will be also affected by the planned cap on interchange fees (although we note that we had already factored in the impact from this on net fees).

Figure 5. Polish Banks – Changes to Net Profit Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
PKO BP	3,762	3,773	0.3%	3,479	3,133	-9.9%	4,483	3,906	-12.9%
Pekao	2,787	2,975	6.8%	2,739	2,346	-14.4%	3,395	2,765	-18.6%
BZ WBK	1,312	1,350	2.9%	1,215	1,182	-2.7%	1,448	1,416	-2.2%
Millennium	419	449	7.2%	318	349	9.7%	600	434	-27.6%
Kredyt Bank	211	312	48.0%	41	129	217.2%	243	249	2.7%
ING Bank Slaski	805	840	4.3%	685	620	-9.4%	1,101	878	-20.3%
BRE	1,123	1,150	2.4%	953	832	-12.7%	1,266	1,071	-15.4%
Getin Noble Bank	409	368	-10.0%	496	371	-25.2%	624	579	-7.2%
Total	10,828	11,218	3.6%	9,926	8,962	-9.7%	13,160	11,298	-14%

Source: Citi Research

Figure 6. Polish Banks – Changes in Net Profit, 2008-2014E (Percentage)



Source: Company reports, Citi Research estimates (2012-14)

Given the material cuts to our 2013E earnings forecasts (-10%) and the 20% yoy decline we expect in banks' net profit, we remain negative on the Polish banking stocks. We think that the market is failing to price in the likely decline in earnings. We note that, in terms of 2013E earnings (excluding Kredyt Bank, which is to be merged with BZ WBK), we are between 14% (Millennium) and 27% (ING BSK) below consensus. We think that cuts to consensus will result in share price weakness.

Figure 7. Polish Banks – Citi vs. Consensus Estimates, 2012E-2013 (Polish Zloty in million)

	Consensus		Citi		Citi vs. consensus		Growth (Consensus)		Growth (Citi)	
	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013
PKO BP	3,850	3,774	3,773	3,133	-2%	-17%	1%	-2%	-1%	-17%
Pekao	2,879	2,895	2,975	2,346	3%	-19%	-1%	1%	3%	-21%
BZ WBK	1,337	1,464	1,350	1,182	1%	-19%	13%	10%	14%	-12%
Millennium	437	407	449	349	3%	-14%	-6%	-7%	-4%	-22%
Kredyt Bank	214	218	312	129	46%	-41%	-35%	2%	-5%	-59%
ING BSK	858	847	840	620	-2%	-27%	-2%	-1%	-5%	-26%
BRE	1,131	1,054	1,150	832	2%	-21%	0%	-7%	1%	-28%
Getin Noble Bank	402	447	368	371	-8%	-17%	69%	11%	55%	1%
Total	11,108	11,105	11,218	8,962	1%	-19%	2%	0%	3%	-20%

Source: Powered by dataCentral

Due to lowered assumptions of sustainable ROE (driven predominantly by lower rates), we downgrade PKO BP to Neutral from Buy and Pekao to Sell from Neutral. Among Polish financial stocks with high dividend yield we prefer Neutral-rated PZU (PZU.WA; ZL391.00; 2) to Pekao. We also change our ratings on two other banks: for Getin Noble Bank to Neutral/High Risk from Neutral (due to high dependence of the bank's earnings on revenues from insurance fees, which could be negatively impacted by announced recommendations on bancassurance) and for Kredyt Bank to Buy from Buy/High Risk (due to reduced risk, in our opinion, that the merger with BZ WBK will not be approved by the regulator. Kredyt Bank and BZ WBK are now our only Buy-rated banks in Poland. We think that the prepared merger of these banks will allow them, through building scale, to partly offset the macro headwinds. We maintain Sell ratings on BRE and Millennium, and a Neutral rating on ING BSK.

Figure 8. Polish Banks – Valuation Multiples

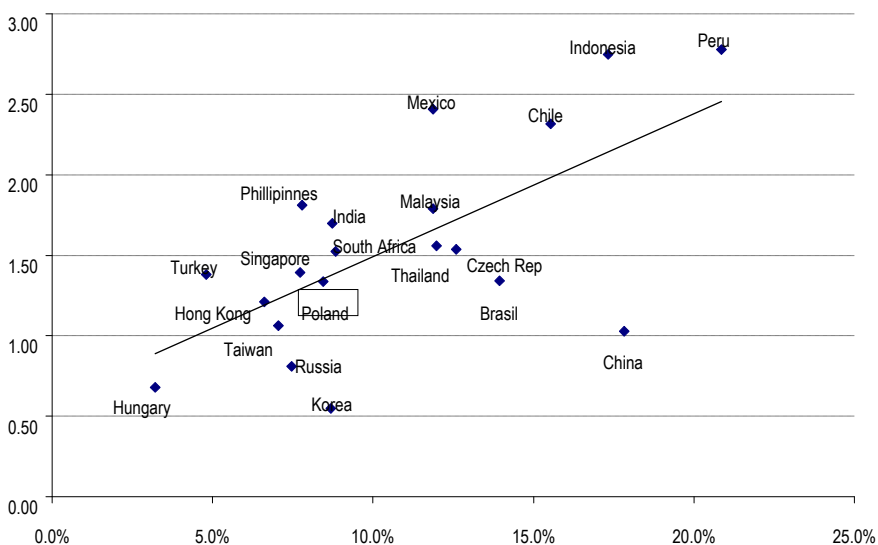
	Current Price	Rating	Target Price	P/E			P/BV			ROE		
				2012E	2013E	2014E	2012E	2013E	2014E	2012E	2013E	2014E
PKO BP	35.1	2	38.1	11.6	14.0	11.2	1.8	1.7	1.6	16%	12%	15%
PEKAO	156.2	3	148	13.8	17.5	14.8	1.8	1.8	1.7	13%	10%	12%
BZ WBK	238.5	1	266	13.1	15.1	12.6	2.1	2.0	1.9	17%	14%	16%
BANK MILLENNIUM	4.25	3	3.7	11.5	14.8	11.9	1.1	1.0	0.9	9%	7%	8%
KREDYT BANK	15.45	1	18.5	13.4	32.6	16.8	1.2	1.2	1.1	10%	4%	7%
ING BSK	88.6	2	92	13.7	18.6	13.1	1.5	1.5	1.4	12%	8%	11%
BRE	312.1	3	279	11.4	15.8	12.3	1.4	1.3	1.2	13%	8%	10%
Getin Noble Bank	1.62	2H	1.81	11.7	11.6	7.4	1.0	0.9	0.8	9%	8%	11%

Source: Powered by dataCentral

Valuations in GEM Context

On our 2013E forecasts Polish banks looks expensive vs. GEM peers (see Fig. 7-9 for details) .

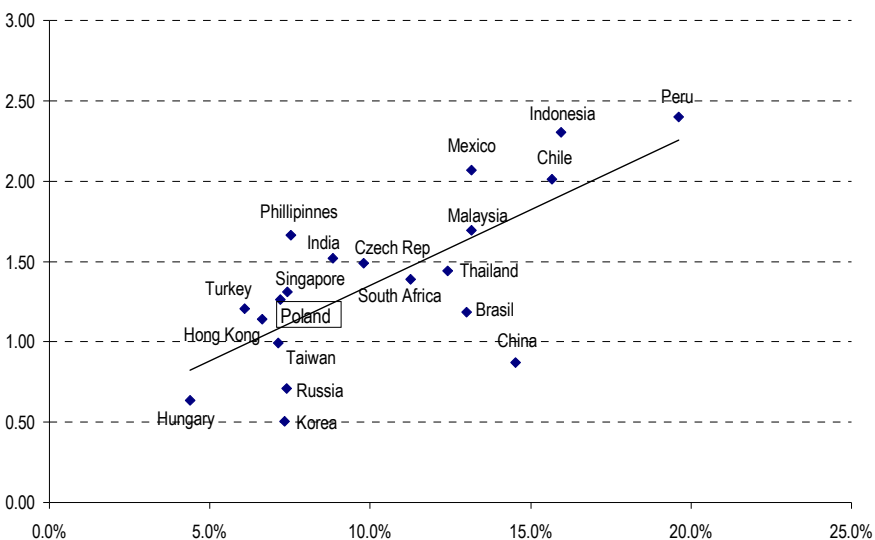
Figure 9. GEM Banks – Real P/BV and Real ROE*, 2012E



* At median, inflation adjusted

Source: Citi Research estimates

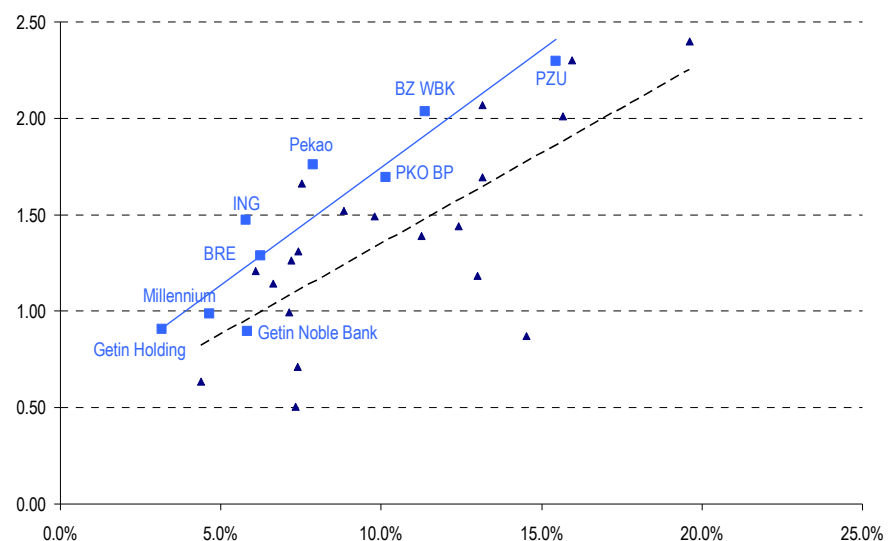
Figure 10. GEM Banks – P/BV and Real ROE*, 2013E



*At median, inflation adjusted

Source: Citi Research estimates

Figure 11. Polish Banks – P/BV and ROE*, 2013E



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

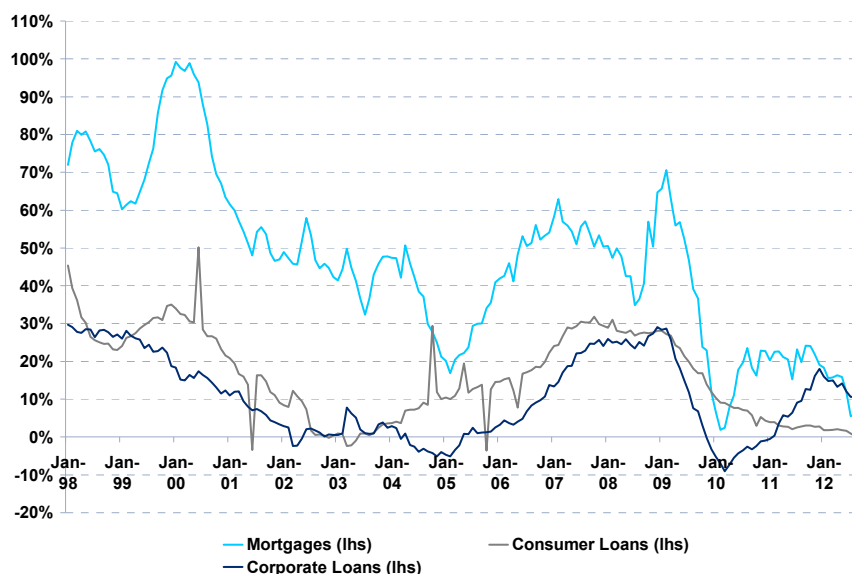
Source: Citi Research estimates

$$1.3\% + (-150\text{bp}) + (-50\text{bp}) - (+10\text{bp}) - (+50\text{bp}) = -20\%$$

The maths look strange but we expect slowdown in macro (to 1.3% GDP growth) combined with an expected 150bp cut in interest rates, 50bp reduction in interchange fee (to c.1.1% from 1.6% now), c10bp increase in contribution to the Bank Guarantee Fund (to c20bp of Risk-Weighted Assets from 9.9bp now) and on average 50bp increase in cost of risk to lead to 20% yoy lower net profit for our universe of eight Polish banks.

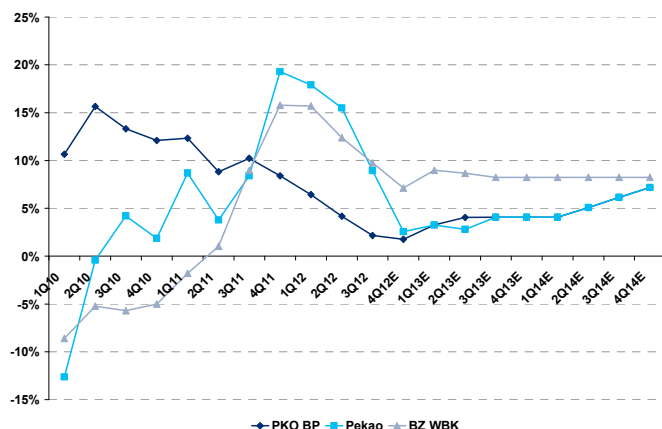
Lending

Figure 12. Polish Banks – Loan Growth, Jan 98-Sep 12 (Percentage)



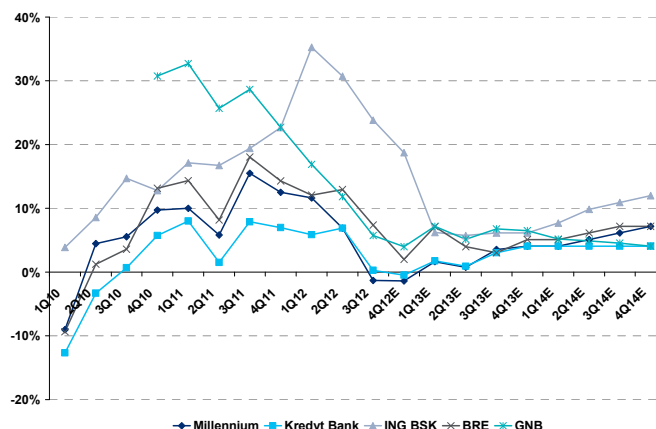
Source: NBP, Citi Research

Figure 13. Polish Banks – Loan Growth in Top 3 Banks, 1Q10-4Q14E (Percentage)



Source: Company reports, Citi Research estimates

Figure 14. Polish Banks – Loan Growth in ex-Top 3 Banks, 1Q10-4Q14E (Percentage)



Source: Company reports, Citi Research estimates

Lending growth has decelerated in the recent quarters for Citi universe of Polish banks (excluding BGZ), reaching +6% yoy in 3Q12 (+5% yoy excluding ING BSK, which saw a rise due partly to the acquisition of leasing and factoring companies).

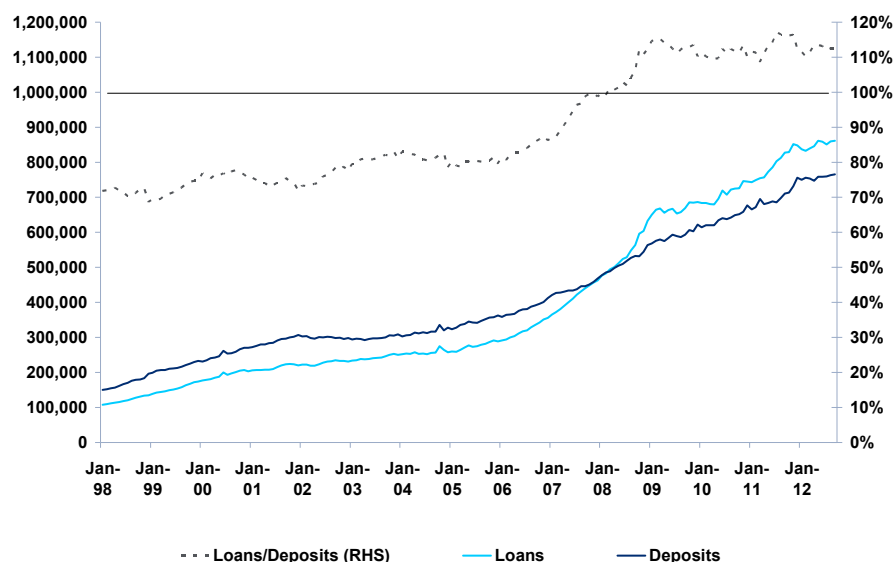
We expect loan dynamics to start to rebound in 2013 due to:

- an end to the negative impact from Zloty appreciation on FX loan volumes;
- a rebound in consumer lending, triggered by regulatory easing and the bank's increased interest in high-margin products; and
- continued growth in corporate loans driven predominantly by investments by the biggest corporations, including state-owned companies.

For a broader analysis of long-term trends in lending see [Polish Financials - Time To Turn Negative](#)

Funding

Figure 15. Polish Banks – Loans and Deposits, Jan 98-Sep 12 (Polish Zloty in million/Percentage)

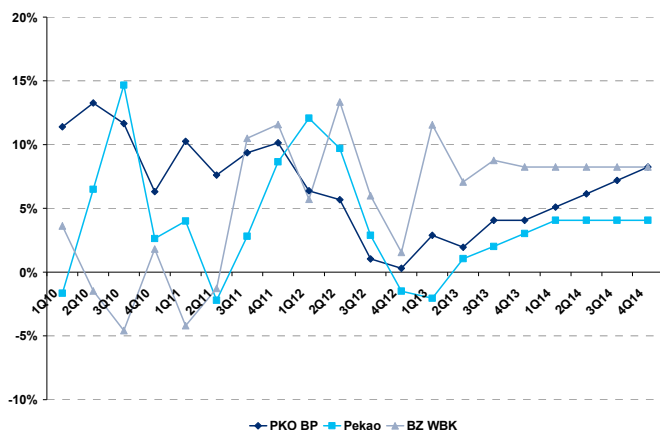


Source: NBP, Citi Research

Deposit dynamics have decelerated as well, negatively affected by corporate deposits (declining 3% yoy in September 2012 vs. 12% growth yoy in 2011), while retail deposits have remained broadly stable (+10% yoy vs. +13% yoy, respectively).

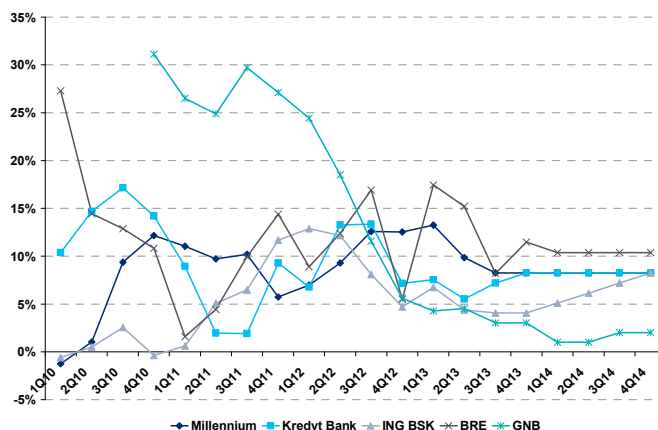
We think that a macro rebound in 2H13E will lead to improved dynamics in corporate deposits. We don't expect outflows of retail money from deposits to investment products because we think that, despite lower interest rates, banks will continue to offer attractive rates to keep a base of stable retail deposits.

Figure 16. Polish Banks – Deposit Growth in Top 3 Banks, 1Q10-4Q14E (Percentage)



Source: Company reports, Citi Research estimates (from 4Q12)

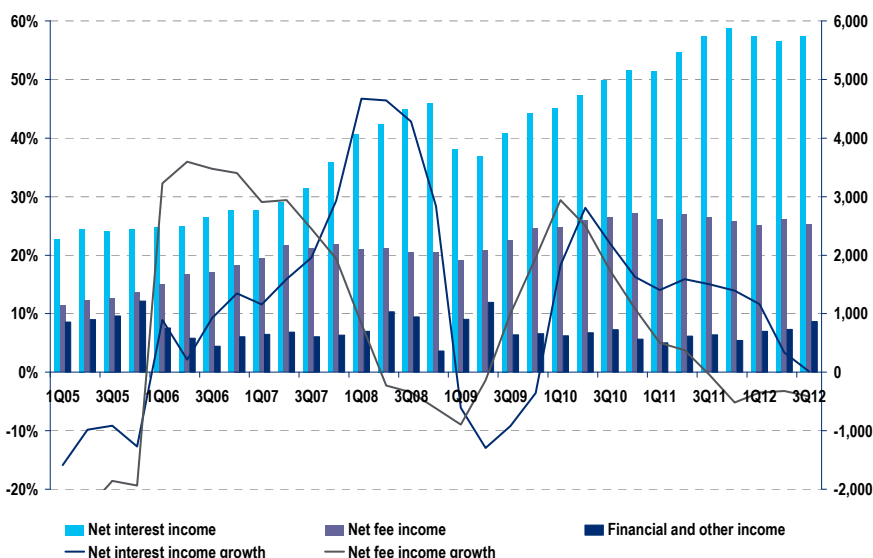
Figure 17. Polish Banks – Deposit Growth in ex-Top 3 Banks, 1Q10-4Q14E (Percentage)



Source: Company reports, Citi Research estimates (from 4Q12)

Net Interest Income

Figure 18. Polish Banks* -- Revenues, 1Q05-3Q12 (Polish Zloty in million/Percentage)

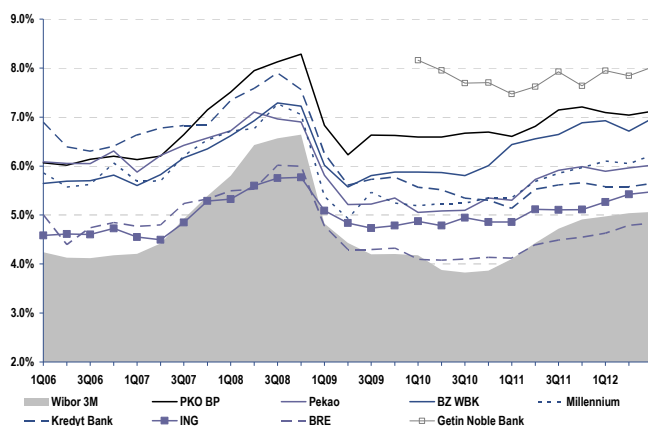


Note: * Citi Universe of Polish banks excluding BGZ

Source: Company reports, Citi Research

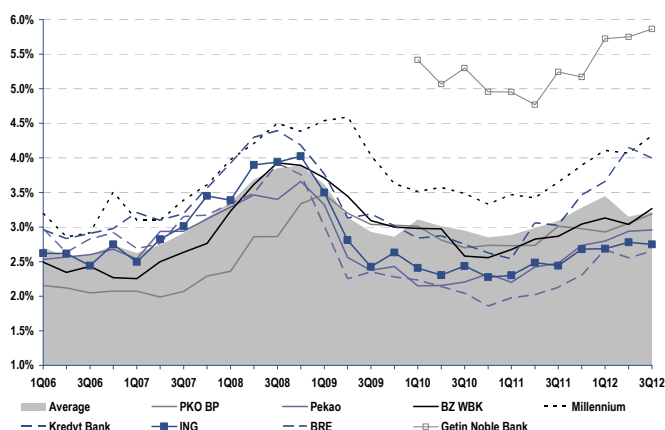
The net interest income of Citi's universe of Polish banks (excluding BGZ) grew 1.4% qoq in 3Q12 and was flat yoy. The net interest margin (NIM) was broadly flat, affected positively by rising yields on interest earning assets and negatively by an increasing cost of funding.

Figure 19. Polish Banks* -- Yield on Interest Earnings Assets, 1Q05-3Q12 (Percentage)



Source: Company reports, Citi Research

Figure 20. Polish Banks* -- Cost of Funding, 1Q05-3Q12 (Percentage)



Source: Company reports, Citi Research

In our opinion, NIM in 2013 will be affected by several factors, including:

- lower short-term interest rates (e.g. Wibor 3M);
- lower long-term rates (we note that yields on 10-year government bonds are at c4.2% vs. Wibor at 4.5%);
- replacement of funding by parents with funding by local depositors (an example of this has been Kredyt Bank, which due to an increased cost of funding from KBC decided to replace part of its borrowing from the parent with local deposits and FX swaps; to some extent, the same process is taking place in BRE);
- growth in wholesale funding, both internationally (several foreign bond issues by PKO BP, Eurobonds issued by BRE) and domestically (e.g. ING BSK issue);
- lower demand for deposits due to lower growth in new lending;
- long-term attempts by banks to increase their base of stable deposits in anticipation of the liquidity provisions of Basel III.

We think that the greatest impact will be from lower rates. Citi's economists expect a 150bp cuts in interest rates (including the first cut in November [Poland Macro View - Rates To Fall To Record Low Levels](#)) vs. consensus forecasts for a 100bp reduction.

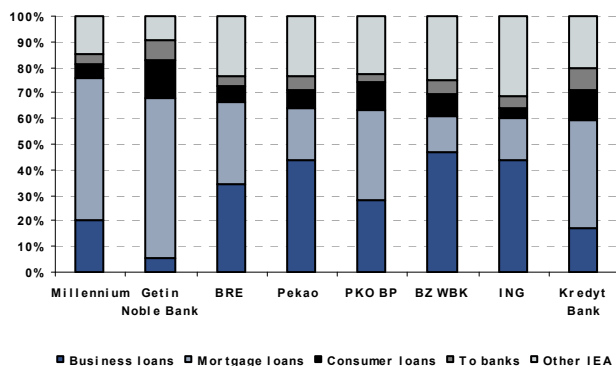
Estimating the impact of lower interest rates on banks' NIM, net interest income and net income, we split assets and liabilities into five groups:

- Re-pricing in less than 3 months (no assets, saving accounts and half of corporate current accounts on the liability side of the balance sheet);
- Re-pricing between 3 and 12 months (business loans and mortgage loans plus lending to banks on the assets side and two-thirds of term deposits and other debt);
- Re-pricing between 12 and 24 months (half of consumer loans and half of other interest-earning assets and one-third of term deposits);

- Re-pricing in more than two years (half of consumer loans and half of other interest-earning assets),
- Not re-pricing at all (no assets, retail current accounts, half of corporate current accounts and equity).

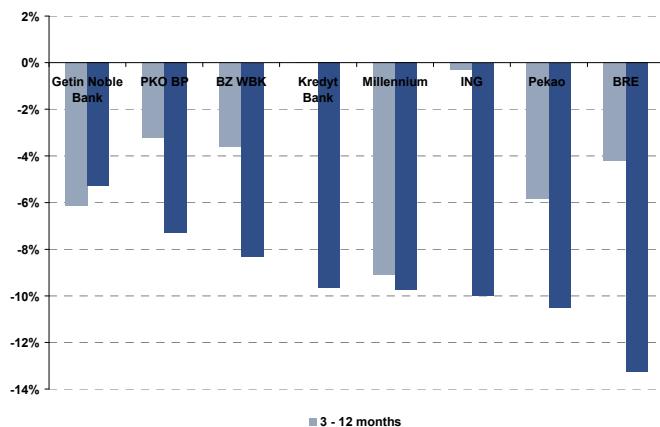
Analysing the impact of lower rates on net interest income (NII) in 12+ months' time, we find that BRE and Pekao are the most exposed (due to their relatively low share of consumer loans in assets, a high share of current retail deposits at BRE and strong capitalization in the case of Pekao). On the other hand, Kredyt Bank and Getin Noble Bank seem least exposed to the risk of low interest rates, due mainly to their low share of retail current accounts and equity, plus their relatively high share of consumer loans in assets. Near term (3 to 12 months), we think the most exposed are Millennium and BRE, due to their high share of mortgages, while the least exposed are Kredyt Bank and ING BSK, benefiting from their high share of savings accounts in liabilities and a high share of fixed rate consumer loans (in the case of Kredyt Bank) and bonds (in the case of ING BSK).

Figure 21. Polish Banks – Structure of Interest Earnings Assets, 2Q12 (Percentage)



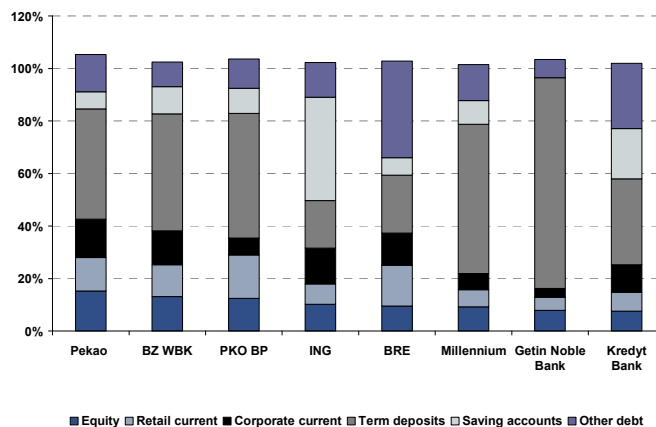
Source: Company reports, Citi Research

Figure 23. Polish Banks – Impact of 100bp Interest Cut on Net Interest Income, 2012E (Percentage)



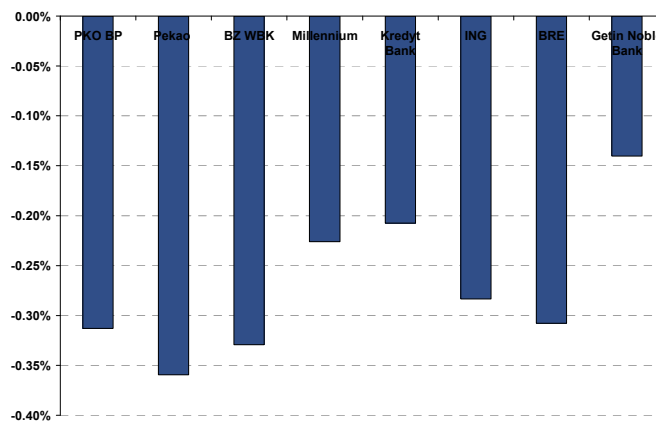
Source: Citi Research estimates

Figure 22. Polish Banks – Interest Bearing Liabilities as % of Interest Earnings Assets, 2Q12 (Percentage)



Source: Company reports, Citi Research

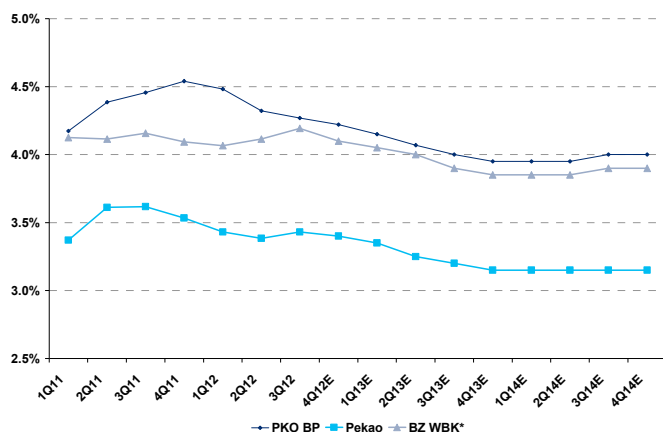
Figure 24. Polish Banks – Impact of 100bp Interest Cut on Net Interest Margin (NIM), 2012E (Percentage)



Source: Citi Research estimates

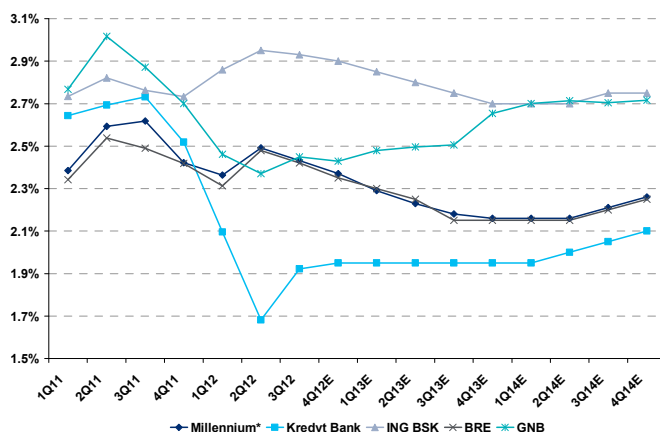
We present below the evolution of the NIMs in the past and our forecasts for 4Q12E-4Q14E.

Figure 25. Polish Banks – NIM in Top 3 Banks, 1Q11-4Q14E
(Percentage)



Source: Company reports, Citi Research estimates

Figure 26. Polish Banks – NIM in ex-Top 3 Banks, 1Q11-4Q14E
(Percentage)



Source: Company reports, Citi Research estimates

Net Fees

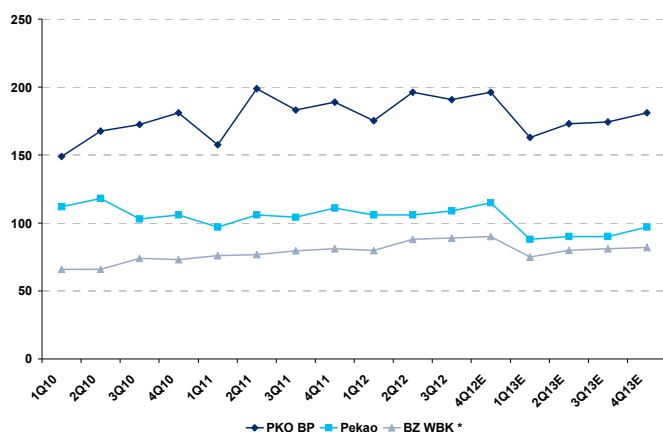
In 3Q12 net fees of Citi's universe of Polish banks (excluding BGZ) declined 4.1% yoy and -3.4% qoq. The decline was caused predominantly by lower lending, account and transfer fees.

In our opinion, net fees in 2013 will be impacted by:

- planned implementation of a cap on interchanges fee at about 1.0-1.1% vs. currently about 1.6-1.7%, partly offset by rising transactions volumes;
- continued decline in account and transfer fees, but we think that the negative impact of 1) client migration to cheaper on-line channels and 2) competition among banks (forcing them to offer services for free) will be partly offset by re-pricing of some products and increasing the eligibility requirement to get services for free (e.g. raising the minimum monthly inflow);
- trends in capital markets (we assume broadly flat investment fund fees and rebounding brokerage fees);
- potentially fee income may be also impacted by announced recommendation on good practice in sale of insurance products through banks.

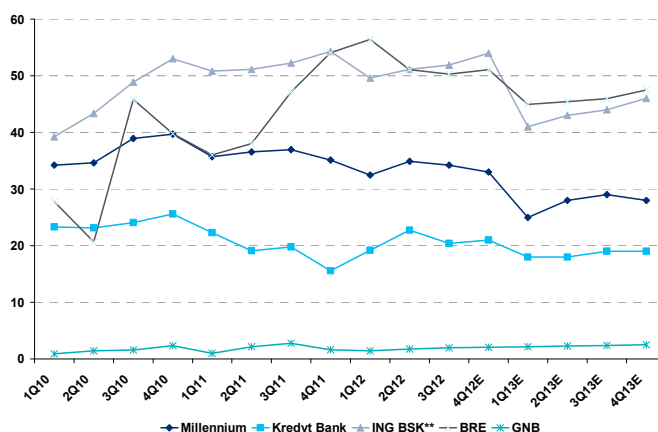
In the following figures we show historical trends and our forecasts for different categories of net fees.

Figure 27. Polish Banks – Card Fees in Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



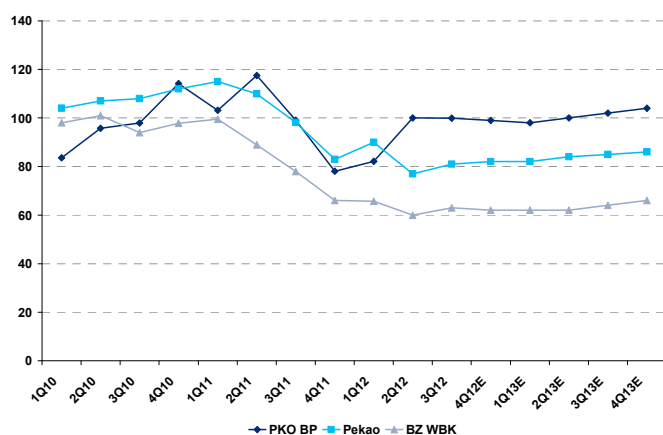
Source: Company reports, Citi Research estimates

Figure 28. Polish Banks – Card Fees in ex-Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



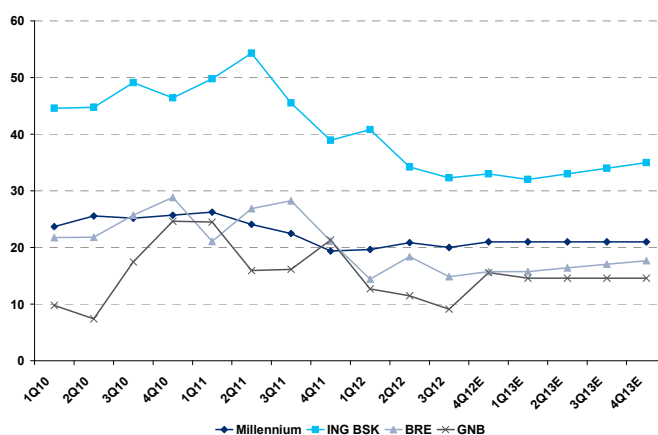
Source: Company reports, Citi Research estimates

Figure 29. Polish Banks – Investment Fund and Brokerage Fee in Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



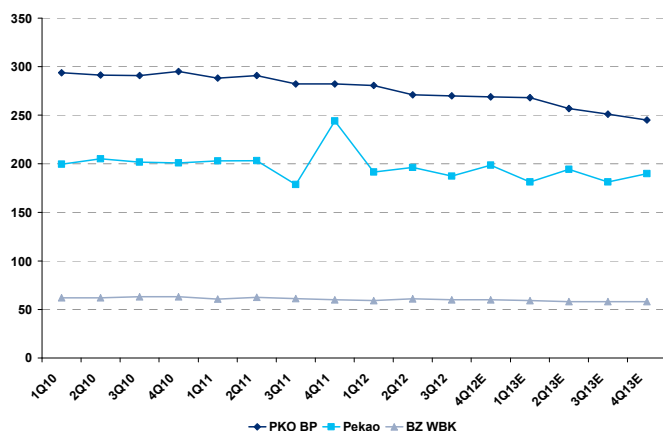
Source: Company reports, Citi Research estimates

Figure 30. Polish Banks – Investment Fund and Brokerage Fee in ex-Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



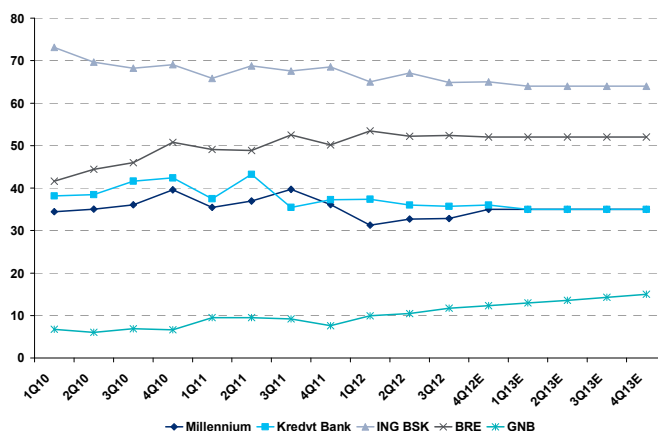
Source: Company reports, Citi Research estimates

Figure 31. Polish Banks – Account and Transfer Fees in Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



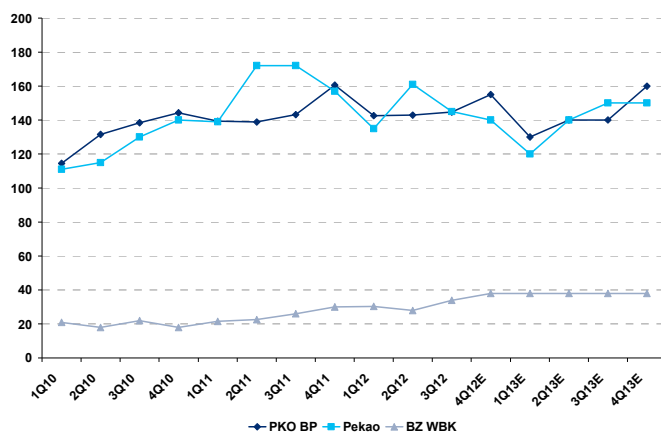
Source: Company reports, Citi Research estimates

Figure 32. Polish Banks – Account and Transfer Fees in ex-Top3 Banks, 1Q10-4Q13E (Polish Zloty in million)



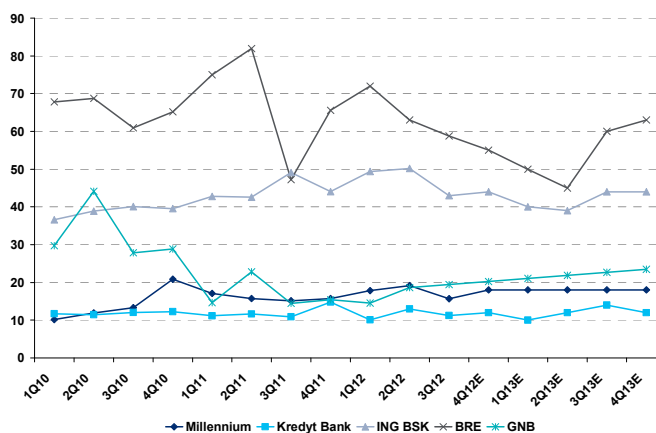
Source: Company reports, Citi Research estimates

Figure 33. Polish Banks – Lending Fees in Top3 Banks, 1Q10-4Q13E
(Polish Zloty in million)



Source: Company reports, Citi Research estimates

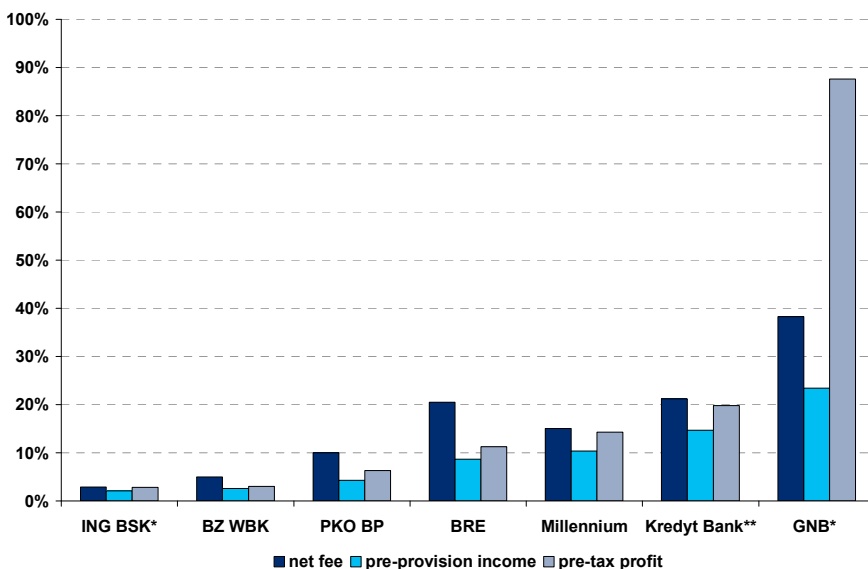
Figure 34. Polish Banks – Lending Fees in ex-Top3 Banks, 1Q10-4Q13E
(Polish Zloty in million)



Source: Company reports, Citi Research estimates

Potentially, fee income may be also impacted by the announced recommendation on good practice in the sale of insurance products through banks. Representatives of the KNF (Polish FSA) have indicated that they would like to eliminate situations where customers are paying for bank insurance, while at the same time banks are receiving commission for selling this same insurance to the clients. Such situations are common in group insurance sold in relation to lending products, and fees from sales of investment product are a crucial part of bank profits on consumer finance products. We don't know whether the new recommendations (expected in December 2012 or January 2013) will only introduce a requirement to re-design agreements between insurers and banks or reduce/eliminate the scope for banks to earn on such products.

Figure 35. Polish Banks – Fees from Sale of Insurance as % of Net Fees, Pre-Provision income and Pre-Tax, 9M12 (Percentage)



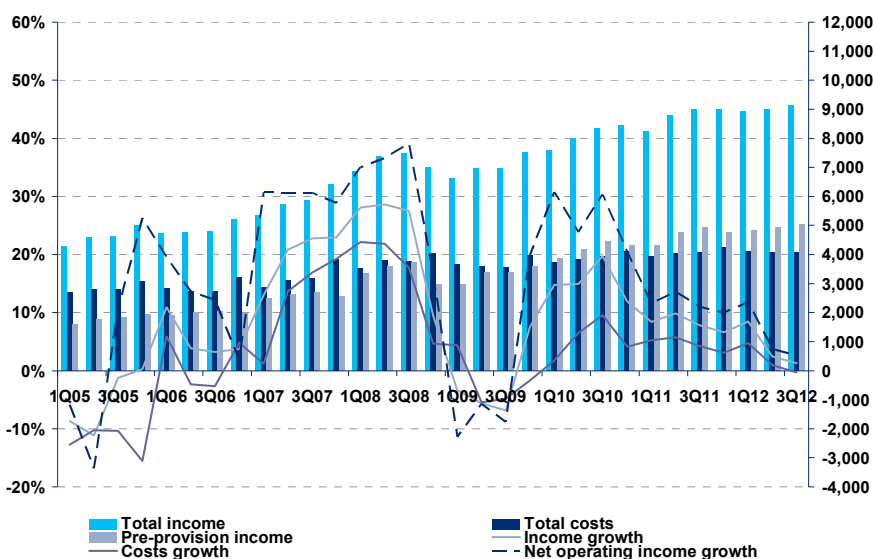
Note: * excluding investment products wrapped as insurance ** 1H12

Source: Company reports, Citi Research

Among our coverage, the most exposed to the regulation of bancassurance is Getin Noble Bank, with a share of insurance fees in total fees as high as some banks that specialise in consumer finance.

Administrative Costs

Figure 36. Polish Banks – Income, Costs and Pre-Provision Income, 1Q05-3Q12 (Polish Zloty in million)



Source: Company reports, Citi Research

In 3Q12 administrative costs for our universe of eight Polish banks were broadly flat (-0.3% yoy), driven by lower staff costs (-1.2% yoy, due mainly to headcount reduction) and rising general costs (+1.4% yoy, but we note that general costs increased only in three banks: in PKO BP due to new projects, in BZ WBK due to a low base and in ING BSK due to consolidation of acquired leasing and factoring companies).

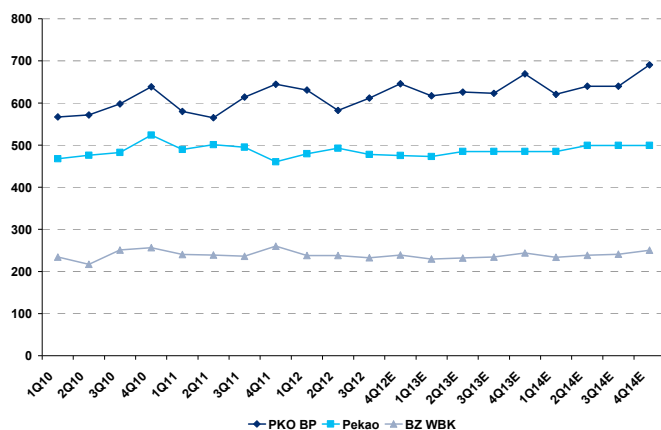
We expect underlying costs to remain flat in 2013E but total administrative costs will most likely be negatively affected by a prepared new bank levy. The government is working on changes in the regulation of the Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny, BFG) and implementation of a new levy that will be used to capitalize a resolution fund that will be run by BFG. The new levy will be based, like the current contribution to BFG for the deposit guarantee fund, on banks' risk-weighted assets. The rate is still not decided, but bank representatives at post-3Q12 result analyst meetings indicated that they thought it would likely be equal to the contribution to the deposit fund (9.9bp). This is broadly in line with indications by Ministry of Finance representatives that expected revenues from the levy would be about ZI 700m. In our previous model we assumed a bank levy at the same rate, but we have now updated our models to take into account the dynamics of banks' risk-weighted assets. We note that in the case of BRE and ING BSK we have taken into account risk-weighted assets calculated according to the standard method while both banks are implementing more advanced methods (Advanced Internal Rating-Based (AIRB) in the case of ING BSK and Internal Rating-Based (IRB) in the case of BRE). If the banks are allowed to use risk-weighted assets calculated according to these more advanced methodologies, their bank levy will be lower than we currently anticipate.

Figure 37. Polish Banks – Impact of Bank Levy on Earnings, 2013E (Polish Zloty in million/Percentage)

	Bank levy	as % of (2013E):		
		administrative costs	pre-tax profit	net profit
PKO BP	162	3%	3%	5%
Pekao	104	3%	3%	4%
BZ WBK	51	3%	2%	4%
Millennium	40	3%	5%	12%
Kredyt Bank	32	3%	6%	25%
ING BSK	48	3%	4%	8%
BRE	73	4%	4%	9%
GNB	45	5%	3%	12%
Total	555	3%	3%	6%

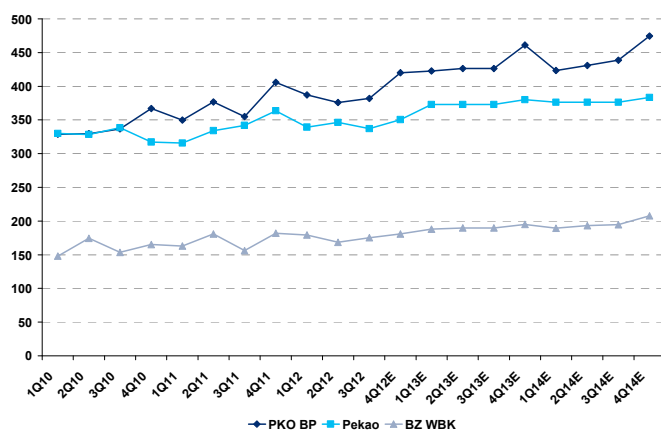
Source: Citi Research estimates

Figure 38. Polish Banks – Staff Costs of Top 3 Banks, 1Q10-4Q12E (Polish Zloty in million)



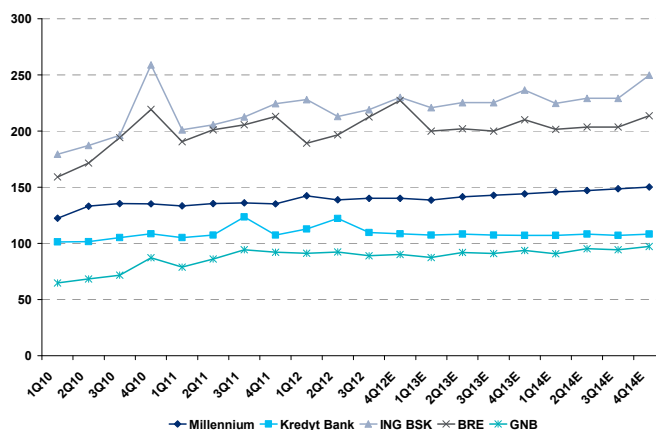
Source: Company reports, Citi Research estimates

Figure 40. Polish Banks – General Costs of Top 3 Banks, 1Q10-4Q12E (Polish Zloty in million)



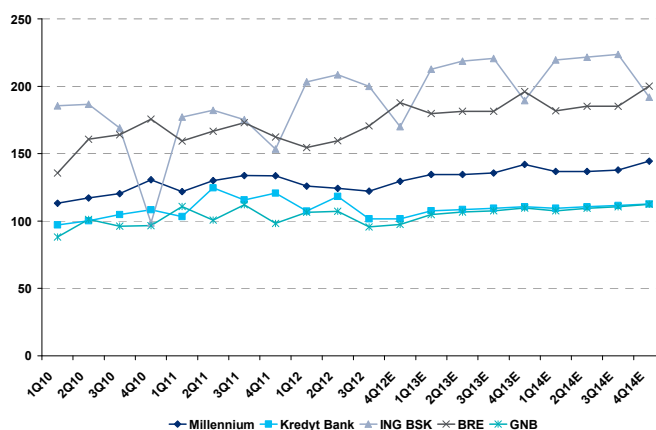
Source: Company reports, Citi Research estimates

Figure 39. Polish Banks – Staff Costs of ex-Top 3 Banks, 1Q10-4Q12E (Polish Zloty in million)



Source: Company reports, Citi Research estimates

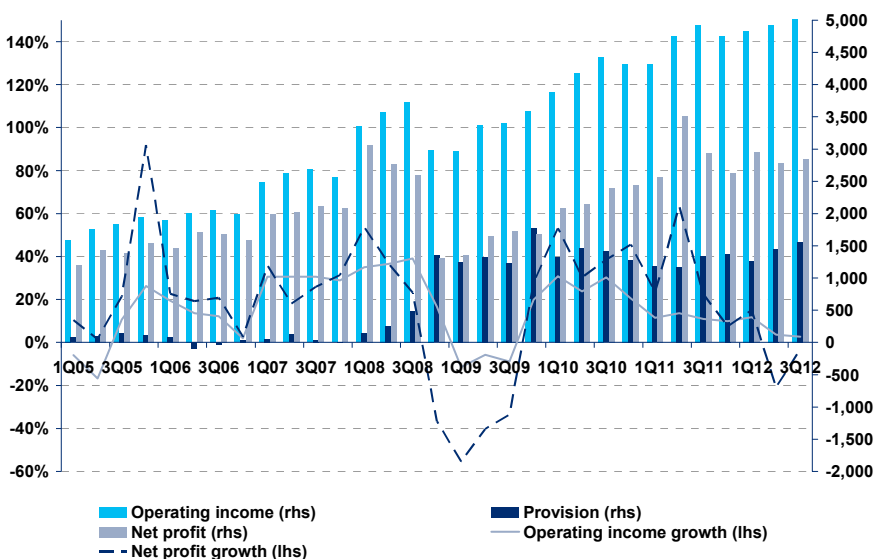
Figure 41. Polish Banks – General Costs of ex-Top 3 Banks, 1Q10-4Q12E (Polish Zloty in million)



Source: Company reports, Citi Research estimates

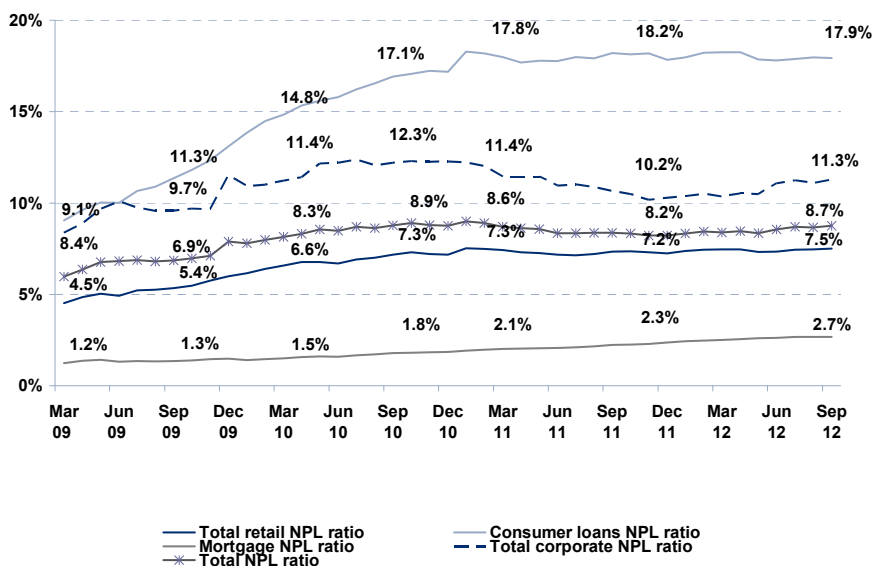
Provisioning

Figure 42. Polish Banks – Operating Profit, provisioning and Net Profit, 1Q05-3Q12 (Polish Zloty in million)



Source: Company reports, Citi Research

Figure 43. Polish Banks –NPL Ratios, Mar 09-Sep 12 (Percentage)



Source: NBP, Citi Research

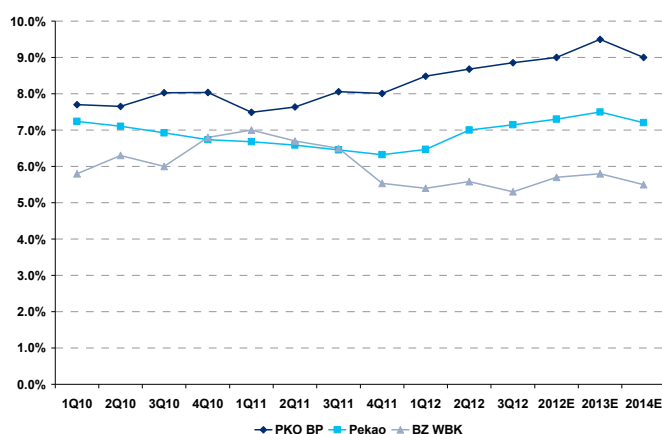
NPLs in corporate loans grew in 2Q12, affected by problems in the construction sector, but since July 2012 have remained broadly stable. Some banks indicate problems in sectors related to construction (e.g. transport or steel industry) but in the opinion of others the problems are equally smoothed across all industries: in all sectors weak players are being hit by the slowdown while the leaders are performing better.

The NPL ratio in consumer loans remains flat, implying that the growth in the volume of NPLs is limited. However, we see a risk that rising unemployment in 2013 may cause deterioration in that area as well.

Mortgages continue to be the segment with the lowest NPL ratio. However, the mortgage NPL ratio has grown steadily, without any visible deceleration, since the end of 2008.

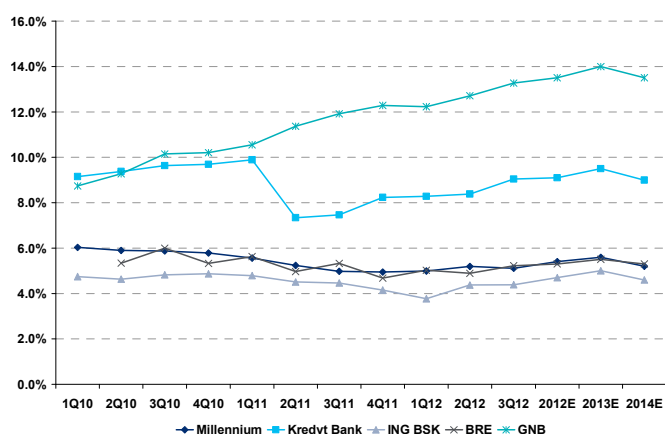
In 2013 we expect higher provisioning in each segment, but we think that provisions on corporate loans will more skewed to 1H13 and retail to 2H13.

Figure 44. Polish Banks – NPL Ratios of Top 3 Banks, 1Q10-2014E
(Polish Zloty in million)



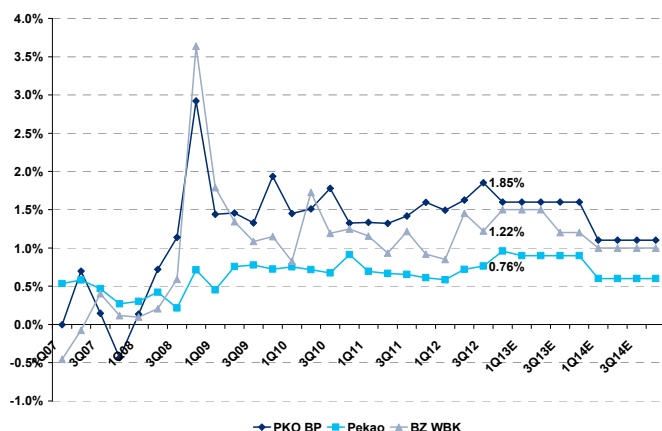
Source: Company reports, Citi Research estimates

Figure 45. Polish Banks – NPL Ratios of ex-Top 3 Banks, 1Q10-2014E
(Polish Zloty in million)



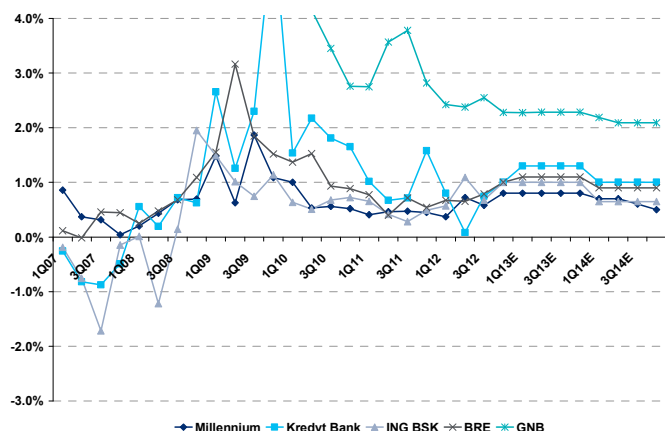
Source: Company reports, Citi Research estimates

Figure 46. Polish Banks – Cost of Risk of Top 3 Banks, 1Q10-2014E
(Polish Zloty in million)



Source: Company reports, Citi Research estimates

Figure 47. Polish Banks – Cost of Risk of ex-Top 3 Banks, 1Q10-2014E
(Polish Zloty in million)



Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

Neutral	2
from Buy	
Price (29 Nov 12)	ZL35.10
Target price	ZL38.10
from ZL40.70	
Expected share price return	8.5%
Expected dividend yield	4.3%
Expected total return	12.8%
Market Cap	ZL43,875M
	US\$13,843M

Price Performance (RIC: PKO.WA, BB: PKO PW)



PKO BP (PKO.WA)

Tough Year Even for the National Champion – Downgrading to Neutral

- **Downgraded to Neutral** — Taking into account reduced earnings estimates, we lower our assumption of sustainable ROE to 14.5% from 16% previously. The negative impact of lower sustainable ROE is only partly offset by lower assumption of cost of risk (10.0% vs. 10.5% previously) and we reduce our TP to ZL 38.1 from ZL 40.7 previously. Given an expected 17% yoy drop in EPS next year, management's indications on potential M&A in 2013 and finally an ETR of below 15% threshold, we downgrade PKO BP to Neutral from Buy.
- **3Q12 In Line** — The bank reported a 3Q12 net profit of ZL 921m (-9% yoy, -3% qoq, +2% vs. Citi estimates and +0.5% vs. consensus as reported by PAP). Higher than expected provisioning (+35% yoy, -15% qoq, +8% vs. consensus) was offset by higher-than-expected financial and other income (ZL 186m vs. consensus at ZL 151m), driven by bond and FX gains.
- **Pessimistic Management Guidance** — The bank's management expects 2013 to be a tough year due to pressure on revenues but cost of risk shouldn't rise vs. 2012. In 1Q13 the bank will present an update of its strategy.
- **2013E EPS Estimates Reduced by 10%** — Due to lower assumption of NIM (4.04% vs. 4.2% in 2013E and 3.96% vs. 4.2% in 2014E, driven by lower rate assumption and weak NIM in 3Q12) and slightly reduced net fee estimates, we cut our revenue forecasts by 4% in 2013E and 6% in 2014E and our EPS estimates by 10% and 13%, respectively.
- **4Q12E Outlook** — We expect ZL 899m (-2% qoq) net profit in 4Q12E, driven by 1% qoq lower revenues, 7% qoq (seasonally) higher administrative costs and 13% qoq lower (due to normalization vs. high base in 3Q12) provisioning.
- **2013E Outlook** — In 2013E we are looking for 3% yoy lower net interest income (negatively driven by 25bp lower NIM), 4% yoy lower net fee (-1% yoy if interchange cap is not implemented), 6% yoy higher administrative costs (+3% yoy if bank levy isn't introduced) and flat provisioning, leading to a 17% decline in EPS.

PKO BP (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	3,216.9	3,807.2	3,772.9	3,133.3	3,906.2
Diluted EPS (ZL)	2.57	3.05	3.02	2.51	3.12
Diluted EPS (Old) (ZL)	2.57	3.05	3.01	2.78	3.59
PE (x)	13.6	11.5	11.6	14.0	11.2
P/BV (x)	2.1	1.9	1.8	1.7	1.6
DPS (ZL)	1.98	1.27	1.51	1.50	1.87
Net Div Yield (%)	5.6	3.6	4.3	4.3	5.3
ROE (%)	15.4	17.2	15.9	12.4	14.5

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	13.6	11.5	11.6	14.0	11.2
P/E reported (x)	13.6	11.5	11.6	14.0	11.2
P/BV (x)	2.1	1.9	1.8	1.7	1.6
P/Adjusted BV diluted (x)	2.1	1.9	1.8	1.7	1.6
Dividend yield (%)	5.6	3.6	4.3	4.3	5.3
Per Share Data (ZL)					
EPS adjusted	2.57	3.05	3.02	2.51	3.12
EPS reported	2.57	3.05	3.02	2.51	3.12
BVPS	17.09	18.26	19.74	20.73	22.35
Tangible BVPS	15.64	16.82	18.15	18.99	20.44
Adjusted BVPS diluted	17.09	18.26	19.74	20.73	22.35
DPS	1.98	1.27	1.51	1.50	1.87
Profit & Loss (ZLm)					
Net interest income	6,516	7,609	7,997	7,746	7,960
Fees and commissions	3,143	3,101	3,046	2,919	3,122
Other operating Income	539	432	573	481	520
Total operating income	10,198	11,142	11,617	11,146	11,602
Total operating expenses	-4,249	-4,411	-4,584	-4,863	-4,999
Oper. profit bef. provisions	5,948	6,731	7,033	6,282	6,603
Bad debt provisions	-1,868	-1,930	-2,333	-2,353	-1,702
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	4,080	4,801	4,700	3,930	4,901
Tax	-866	-976	-944	-787	-981
Extraord./Min. Int./Pref. Div.	3	-17	17	-10	-14
Attributable profit	3,217	3,807	3,773	3,133	3,906
Adjusted earnings	3,217	3,807	3,773	3,133	3,906
Growth Rates (%)					
EPS adjusted	24.1	18.4	-0.9	-17.0	24.7
Oper. profit bef. prov.	28.6	13.2	4.5	-10.7	5.1
Balance Sheet (ZLm)					
Total assets	169,661	190,748	194,952	201,933	214,026
Avg interest earning assets	156,802	173,884	186,350	191,662	200,873
Customer loans	135,525	147,293	150,815	157,554	168,421
Gross NPLs	10,887	11,797	13,573	14,968	15,158
Liab. & shar. funds	169,661	190,748	194,952	201,933	214,026
Total customer deposits	132,981	146,474	146,899	152,863	165,464
Reserve for loan losses	4,857	5,658	6,683	7,569	7,664
Shareholders' equity	21,358	22,823	24,670	25,917	27,943
Profitability/Solvency Ratios (%)					
ROE adjusted	15.4	17.2	15.9	12.4	14.5
Net interest margin	4.16	4.38	4.29	4.04	3.96
Cost/income ratio	41.7	39.6	39.5	43.6	43.1
Cash cost/average assets	2.6	2.4	2.4	2.5	2.4
NPLs/customer loans	8.0	8.0	9.0	9.5	9.0
Reserve for loan losses/NPLs	44.6	48.0	49.2	50.6	50.6
Bad debt prov./avg. cust. loans	1.5	1.4	1.6	1.5	1.0
Loans/deposit ratio	101.9	100.6	102.7	103.1	101.8
Tier 1 capital ratio	11.3	11.2	11.7	11.6	11.8
Total capital ratio	12.5	12.4	13.7	12.6	12.7

For further data queries on Citi's full coverage universe
please contact Citi Research Data Services at
CitiRsch.DataServices.Global@citi.com



PKO BP Financials

Changes in Estimates

Figure 48. PKO BP – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)
Net Interest Income	7,999	7,997	0.0%	8,142	7,746	-4.9%	8,670	7,960	-8.2%
Net Fee & Commission Income	3,029	3,046	0.6%	2,986	2,919	-2.2%	3,216	3,122	-2.9%
Financial Income	36	87	142.1%	-20	-30	50.0%	-20	0	NA
Other Income	455	486	6.6%	477	511	7.0%	504	520	3.2%
Total Revenue	11,519	11,617	0.8%	11,585	11,146	-3.8%	12,370	11,602	-6.2%
Labour Costs	-2,468	-2,471	0.1%	-2,518	-2,535	0.7%	-2,573	-2,591	0.7%
General Costs	-1,553	-1,565	0.8%	-1,711	-1,737	1.5%	-1,761	-1,768	0.4%
Depreciation	-548	-548	0.0%	-592	-592	0.0%	-641	-640	0.0%
Operating Expenses	-4,570	-4,584	0.3%	-4,820	-4,863	0.9%	-4,975	-4,999	0.5%
Operating Profit	6,949	7,033	1.2%	6,765	6,282	-7.1%	7,395	6,603	-10.7%
Provision Charge	-2,249	-2,333	3.7%	-2,400	-2,353	-2.0%	-1,769	-1,702	-3.8%
Share of Profits (Losses) of Associates	8	15	92.2%	4	4	0.0%	4	4	0.0%
Profit Before Tax	4,708	4,715	0.1%	4,369	3,934	-10.0%	5,630	4,905	-12.9%
Minorities	2	2	-28.0%	-16	-14	-13.8%	-20	-18	-12.3%
Tax	-948	-944	-0.4%	-874	-787	-10.0%	-1,126	-981	-12.9%
Other	0	0	NA	0	0	NA	0	0	NA
Net Profit	3,762	3,773	0.3%	3,479	3,133	-9.9%	4,483	3,906	-12.9%
EPS (Zl)	3.01	3.02	0.3%	2.78	2.51	-9.9%	3.59	3.12	-12.9%
DPS (Zl)	1.20	1.51	25.3%	1.67	1.50	-9.9%	2.15	1.87	-12.9%
Average Diluted Number of Shares (m)	1,250	1,250	0.0%	1,250	1,250	0.0%	1,250	1,250	0.0%

Source: Citi Research

Figure 49. PKO BP – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)
Cash and NBP Balances	9,279	9,279	0.0%	9,418	9,418	0.0%	9,560	9,560	0.0%
Interbank placements	2,444	2,444	0.0%	2,493	2,493	0.0%	2,543	2,543	0.0%
Financial Assets & Securities	31,237	32,435	3.8%	32,794	33,136	1.0%	34,418	33,853	-1.6%
Net client lending	145,603	144,133	-1.0%	154,538	149,985	-2.9%	167,276	160,757	-3.9%
Fixed assets	2,618	2,618	0.0%	2,696	2,696	0.0%	2,777	2,777	0.0%
Other assets	4,123	4,044	-1.9%	4,426	4,204	-5.0%	4,865	4,536	-6.8%
Total Assets	195,304	194,952	-0.2%	206,365	201,933	-2.1%	221,439	214,026	-3.3%
Interbank borrowing	4,995	4,995	0.0%	5,145	5,145	0.0%	4,631	4,631	0.0%
Client deposits	149,941	146,899	-2.0%	159,134	152,863	-3.9%	172,252	165,464	-3.9%
Other liabilities	15,553	18,391	18.2%	15,284	17,999	17.8%	15,342	15,965	4.1%
Minorities	-3	-3	-25.1%	9	8	-9.6%	26	23	-11.4%
Equity (ex Minorities)	24,819	24,670	-0.6%	26,793	25,917	-3.3%	29,189	27,943	-4.3%
Total liabilities & Equity	195,304	194,952	-0.2%	206,365	201,933	-2.1%	221,439	214,026	-3.3%
BVPS (Zl)	19.85	19.73	-0.6%	21.44	20.74	-3.3%	23.37	22.37	-4.3%

Source: Citi Research

Figure 50. PKO BP – Changes in Key Ratios Sheet Estimates, 2012E-2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	4.29%	4.29%	4.20%	4.04%	4.20%	3.96%
NIM on Total Ave. Assets	4.14%	4.15%	4.05%	3.90%	4.05%	3.83%
Net Fee & Commission Income/Total Income	26.3%	26.2%	25.8%	26.2%	26.0%	26.9%
Net Fee & Commission Income/Deposits	2.0%	2.1%	1.9%	1.9%	1.9%	1.9%
Cost/Income	39.7%	39.5%	41.6%	43.6%	40.2%	43.1%
Cost/Avg. Assets	2.4%	2.4%	2.4%	2.5%	2.3%	2.4%
Effective tax rate	20.1%	20.0%	20.0%	20.0%	20.0%	20.0%
Dividend Payout Ratio	40.0%	50.0%	60.0%	60.0%	60.0%	60.0%
Provisions/Avg Net Loans	1.57%	1.63%	1.60%	1.60%	1.10%	1.10%
Equity/Assets	12.7%	12.7%	13.0%	12.8%	13.2%	13.1%
Loans/Deposits	97.1%	98.1%	97.1%	98.1%	97.1%	97.2%
Loans/Total Assets	74.6%	73.9%	74.9%	74.3%	75.5%	75.1%
ROE	15.8%	15.9%	13.5%	12.4%	16.0%	14.5%
ROA	1.95%	1.96%	1.73%	1.58%	2.10%	1.88%
RWA/Total Assets	82.0%	83.0%	82.0%	83.0%	82.0%	83.0%
Tier I Ratio (%)	11.6%	11.7%	11.9%	11.6%	12.1%	11.8%
CAR	12.6%	13.7%	12.8%	12.6%	12.9%	12.7%
Bank Employees	28,267	28,323	27,706	27,760	27,706	27,760

Source: Citi Research

Financials

Figure 51. PKO BP – Income Statement, 2007-2014E (Polish Zloty in million)

	2007	2008	chg (%)	2009	chg (%)	2010	chg (%)	2011	chg (%)	2012E	chg (%)	2013E	chg (%)	2014E	chg (%)
Net Interest Income	4,644	6,127	31.9%	5,051	-17.6%	6,516	29.0%	7,609	16.8%	7,997	5.1%	7,746	-3.1%	7,960	2.8%
Net Fee & Commission Income	2,335	2,412	3.3%	2,583	7.1%	3,143	21.7%	3,101	-1.3%	3,046	-1.8%	2,919	-4.2%	3,122	6.9%
Financial Income	-65	-166	155.3%	58	NA	10	-82.0%	-55	NA	87	NA	-30	NA	0	NA
Other Income	830	1,015	22.3%	1,175	15.8%	528	-55.1%	487	-7.8%	486	-0.2%	511	5.2%	520	1.8%
Total Revenue	7,744	9,388	21.2%	8,868	-5.5%	10,198	15.0%	11,142	9.3%	11,617	4.3%	11,146	-4.1%	11,602	4.1%
Labour Costs	-2,289	-2,429	6.1%	-2,308	-5.0%	-2,375	2.9%	-2,404	1.2%	-2,471	2.8%	-2,535	2.6%	-2,591	2.2%
General Costs	-1,413	-1,437	1.7%	-1,467	2.1%	-1,362	-7.2%	-1,487	9.2%	-1,565	5.2%	-1,737	11.0%	-1,768	1.8%
Depreciation	-381	-430	13.0%	-469	9.1%	-512	9.2%	-520	1.5%	-548	5.4%	-592	7.9%	-640	8.2%
Operating Expenses	-4,083	-4,296	5.2%	-4,244	-1.2%	-4,249	0.1%	-4,411	3.8%	-4,584	3.9%	-4,863	6.1%	-4,999	2.8%
Operating Profit	3,662	5,092	39.1%	4,624	-9.2%	5,948	28.6%	6,731	13.2%	7,033	4.5%	6,282	-10.7%	6,603	5.1%
Provision Charge	-57	-1,130	1896%	-1,681	48.7%	-1,868	11.1%	-1,930	3.3%	-2,333	20.8%	-2,353	0.9%	-1,702	-27.6%
Associate Income	4	16	256.7%	0	-97.8%	-1	NA	-20	2311%	15	NA	4	-74.1%	4	0.0%
Profit Before Tax	3,609	3,977	10.2%	2,943	-26.0%	4,079	38.6%	4,781	17.2%	4,715	-1.4%	3,934	-16.6%	4,905	24.7%
Minorities	-38	-19	-51.0%	-6	-66.3%	4	NA	2	-39.9%	2	-30.5%	-14	NA	-18	31.5%
Tax	-668	-838	25.5%	-631	-24.7%	-866	37.2%	-976	12.7%	-944	-3.3%	-787	-16.7%	-981	24.7%
Other	0	0	NA	0	NA	0	NA	0	NA	0	NA	0	NA	0	NA
Net Profit	2,904	3,121	7.5%	2,306	-26.1%	3,217	39.5%	3,807	18.4%	3,773	-0.9%	3,133	-17.0%	3,906	24.7%
EPS (Zl)	2.68	2.88	7.5%	2.07	-28.0%	2.57	24.1%	3.05	18.4%	3.02	-0.9%	2.51	-17.0%	3.12	24.7%
DPS (Zl)	1.01	0.92	-8.3%	1.90	105.9%	1.98	4.2%	1.27	-35.9%	1.51	18.8%	1.50	-0.3%	1.87	24.7%
Average Diluted Number of Shares (m)	1,084	1,084	0.0%	1,112	2.6%	1,250	12.4%	1,250	0.0%	1,250	0.0%	1,250	0.0%	1,250	0.0%

Source: Company reports, Citi Research estimates

Figure 52. PKO BP – Balance Sheet, 2007-2014E (Polish Zloty in million)

	2007	2008	chg (%)	2009	chg (%)	2010	chg (%)	2011	chg (%)	2012E	chg (%)	2013E	chg (%)	2014E	chg (%)
Cash and NBP Balances	4,683	5,837	24.6%	7,094	21.5%	6,182	-12.9%	9,142	47.9%	9,279	1.5%	9,418	1.5%	9,560	1.5%
Interbank placements	5,261	3,364	-36.1%	2,023	-39.9%	2,307	14.0%	2,396	3.9%	2,444	2.0%	2,493	2.0%	2,543	2.0%
Financial Assets & Securities	16,790	18,264	8.8%	24,557	34.5%	24,200	-1.5%	31,236	29.1%	32,435	3.8%	33,136	2.2%	33,853	2.2%
Net client lending	76,417	101,108	32.3%	116,573	15.3%	130,668	12.1%	141,634	8.4%	144,133	1.8%	149,985	4.1%	160,757	7.2%
Fixed assets	4,004	4,317	7.8%	4,350	0.8%	4,378	0.6%	4,341	-0.8%	4,598	5.9%	4,874	6.0%	5,173	6.1%
Other assets	1,383	1,746	26.3%	1,881	7.8%	1,924	2.3%	1,998	3.8%	2,064	3.3%	2,026	-1.8%	2,141	5.7%
Total Assets	108,538	134,636	24.0%	156,479	16.2%	169,661	8.4%	190,748	12.4%	194,952	2.2%	201,933	3.6%	214,026	6.0%
Interbank borrowing	4,704	6,991	48.6%	5,153	-26.3%	5,237	1.6%	6,243	19.2%	4,995	-20.0%	5,145	3.0%	4,631	-10.0%
Client deposits	86,580	102,939	18.9%	125,073	21.5%	132,981	6.3%	146,474	10.1%	146,899	0.3%	152,863	4.1%	165,464	8.2%
Other liabilities	5,275	10,707	103.0%	5,817	-45.7%	10,082	73.3%	15,210	50.9%	18,391	20.9%	17,999	-2.1%	15,965	-11.3%
Minorities	58	46	-20.4%	7	-84.1%	2	-72.8%	-1	NA	-3	95.8%	8	NA	23	171.1%
Equity (ex Minorities)	11,921	13,952	17.0%	20,429	46.4%	21,358	4.5%	22,823	6.9%	24,670	8.1%	25,917	5.1%	27,943	7.8%
Total liabilities & Equity	108,538	134,636	24.0%	156,479	16.2%	169,661	8.4%	190,748	12.4%	194,952	2.2%	201,933	3.6%	214,026	6.0%
Interest Earning Assets	103,151	128,662	24.7%	150,247	16.8%	163,358	8.7%	184,409	12.9%	188,291	2.1%	195,033	3.6%	206,713	6.0%
BVPS (Zl)	11.05	12.92	16.9%	16.35	26.6%	17.09	4.5%	18.26	6.8%	19.73	8.1%	20.74	5.1%	22.37	7.9%

Source: Company reports, Citi Research estimates

Figure 53. PKO BP – Key Ratios, 2007-2014E (Percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	4.63%	5.29%	3.62%	4.16%	4.38%	4.29%	4.04%	3.96%
NIM on Total Ave. Assets	4.41%	5.04%	3.47%	4.00%	4.22%	4.15%	3.90%	3.83%
Net Fee & Commission Income/Total Income	30.2%	25.7%	29.1%	30.8%	27.8%	26.2%	26.2%	26.9%
Net Fee & Commission Income/Deposits	2.7%	2.3%	2.1%	2.4%	2.1%	2.1%	1.9%	1.9%
Cost/Income	52.7%	45.8%	47.9%	41.7%	39.6%	39.5%	43.6%	43.1%
Cost/Avg. Assets	3.9%	3.5%	2.9%	2.6%	2.4%	2.4%	2.5%	2.4%
Effective tax rate	18.5%	21.1%	21.5%	21.2%	20.4%	20.0%	20.0%	20.0%
Dividend Payout Ratio	37.5%	32.0%	103.0%	76.9%	41.7%	50.0%	60.0%	60.0%
Provisions/Avg Net Loans	0.08%	1.27%	1.54%	1.51%	1.42%	1.63%	1.60%	1.10%
Equity/Assets	11.0%	10.4%	13.1%	12.6%	12.0%	12.7%	12.8%	13.1%
Loans/Deposits	88.3%	98.2%	93.2%	98.3%	96.7%	98.1%	98.1%	97.2%
Loans/Total Assets	70.4%	75.1%	74.5%	77.0%	74.3%	73.9%	74.3%	75.1%
ROE	26.4%	24.1%	13.4%	15.4%	17.2%	15.9%	12.4%	14.5%
ROA	2.76%	2.57%	1.58%	1.97%	2.11%	1.96%	1.58%	1.88%
NPLs/Total Loans	3.19%	3.67%	8.13%	8.03%	8.01%	9.00%	9.50%	9.00%
Provision Coverage of NPLs	96.2%	76.4%	40.2%	44.6%	48.0%	49.2%	50.6%	50.6%
RWA/Total Assets	76.5%	84.7%	77.1%	83.3%	77.8%	83.0%	83.0%	83.0%
Tier I Ratio (%)	10.2%	9.9%	13.5%	11.3%	11.2%	11.7%	11.6%	11.8%
CAR	12.0%	11.3%	14.8%	12.5%	12.4%	13.7%	12.6%	12.7%
Bank Employees	30,659	29,064	31,098	29,780	28,924	28,323	27,760	27,760

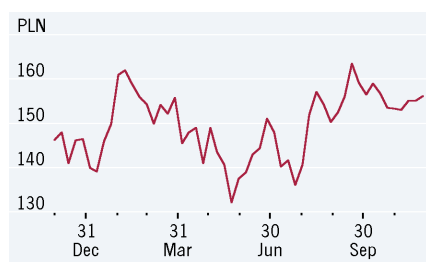
Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

Sell	3
<i>from Neutral</i>	
Price (29 Nov 12)	ZL157.00
Target price	ZL148.00
<i>from ZL152.00</i>	
Expected share price return	-5.7%
Expected dividend yield	5.1%
Expected total return	-0.6%
Market Cap	ZL41,200M
	US\$12,999M

Price Performance (RIC: PEO.WA, BB: PEO PW)



Bank Pekao SA (PEO.WA) Dividend Isn't Enough – Downgrading to Sell

■ **Downgrading to Sell** — Taking into account reduced earnings estimates, we lower our assumption of sustainable reported ROE to 13% from 14% previously and our assumption of capital-normalised ROE to 18.5% from 21%. The negative impact of lower sustainable ROE is only partly offset by lower assumption of cost of equity (10.0% vs. 10.5% previously) and using a weighted average of our standard Warranted Equity Valuations based on reported (60% weight) and capital-normalised (40% weight) ROE we set our target price at ZL 148 (vs. 152 previously). Given a negative ETR, we downgrade Pekao to Sell from Neutral.

■ **PZU a Better Dividend Play** — We perceive PZU (Neutral, TP ZL 418) as a better dividend play in Polish financials than Pekao due to: 1) higher ROE (18% vs. 13% in 2013E) despite similar P/BV valuations, 2) lower P/E valuation (2013E PE c.13.5x vs. c.17.5x) and higher 2013E dividend yield (6.9% vs. 5.5%) and 3) a lesser impact from the economic slowdown on PZU's earnings.

■ **3Q12 Beat** — Pekao reported a 3Q12 net profit of ZL 798m (+4% yoy, +13% qoq, +14% vs. Citi estimates and +14% vs. consensus as reported by PAP). The earnings beat was driven by gains on AFS securities and low administrative costs (-2.7% qoq, -2.5% vs. consensus), while core revenues were mixed (net interest income +1% vs. consensus, net fees -3% vs. consensus).

■ **Optimistic Management Guidance** — Management expects NPLs to rise until mid-2013 but Pekao's cost of risk to remain at half the market average. It sees the annual net profit impact of 75bp lower interest rates at ZL 110-130m (vs. our estimation of ZL c210m in the first year and ZL c380m in the next years).

■ **2013E EPS Estimate Cut by 15%** — We cut our NIM estimates to 3.24% from 3.35% in 2013E and to 3.14% from 3.40% in 2014E. We cut our net fee estimates by 9% and 8%. The negative impact of lower revenues (-8% and -11%, respectively) is only partly offset by reduced administrative costs (-3% in 2013E and 2014E), and we cut our EPS estimates by 15% and 19%, respectively.

■ **4Q12E Outlook** — We are looking for ZL 762m net profit in 4Q12E, driven by flat revenues (owing to the continuation of gains on bonds), administrative costs rising 1% qoq and provisioning increasing by 26%.

■ **2013E Outlook** — We expect EPS in 2013E to decline 21% due to NIM declining by 18bp, net fees declining by 5% yoy (-2% excluding impact of interchange fee cap), administrative costs rising by 4% yoy (+1.3% excluding bank levy) and provisioning rising by 23% yoy.

Bank Pekao SA (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	2,539.6	2,899.4	2,975.2	2,345.7	2,764.9
Diluted EPS (ZL)	9.68	11.05	11.34	8.94	10.53
Diluted EPS (Old) (ZL)	9.63	11.05	10.62	10.44	12.94
PE (x)	16.2	14.2	13.9	17.6	14.9
P/BV (x)	2.0	1.9	1.8	1.8	1.7
DPS (ZL)	6.80	5.38	8.00	8.60	10.00
Net Div Yield (%)	4.3	3.4	5.1	5.5	6.4
ROE (%)	13.2	14.0	13.4	10.1	11.7

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	16.2	14.2	13.9	17.6	14.9
P/E reported (x)	16.2	14.2	13.9	17.6	14.9
P/BV (x)	2.0	1.9	1.8	1.8	1.7
P/Adjusted BV diluted (x)	2.0	1.9	1.8	1.8	1.7
Dividend yield (%)	4.3	3.4	5.1	5.5	6.4
Per Share Data (ZL)					
EPS adjusted	9.68	11.05	11.34	8.94	10.53
EPS reported	9.68	11.05	11.34	8.94	10.53
BVPS	76.89	81.07	87.91	88.85	90.79
Tangible BVPS	74.24	78.39	85.15	86.01	87.86
Adjusted BVPS diluted	76.86	81.05	87.88	88.82	90.76
DPS	6.80	5.38	8.00	8.60	10.00
Profit & Loss (ZLm)					
Net interest income	4,104	4,558	4,783	4,663	4,758
Fees and commissions	2,368	2,449	2,248	2,127	2,325
Other operating Income	821	739	999	754	796
Total operating income	7,293	7,746	8,030	7,545	7,879
Total operating expenses	-3,656	-3,679	-3,672	-3,823	-3,914
Oper. profit bef. provisions	3,636	4,067	4,359	3,722	3,965
Bad debt provisions	-589	-544	-711	-874	-613
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	3,048	3,523	3,647	2,848	3,352
Tax	-571	-684	-715	-553	-651
Extraord./Min. Int./Pref. Div.	63	60	43	51	64
Attributable profit	2,539	2,899	2,975	2,346	2,765
Adjusted earnings	2,540	2,899	2,975	2,346	2,765
Growth Rates (%)					
EPS adjusted	5.2	14.1	2.6	-21.2	17.9
Oper. profit bef. prov.	4.7	11.8	7.2	-14.6	6.5
Balance Sheet (ZLm)					
Total assets	134,090	146,590	148,893	154,688	164,225
Avg interest earning assets	126,246	132,477	140,058	144,183	151,464
Customer loans	81,856	97,239	100,047	104,477	111,833
Gross NPLs	5,714	6,320	7,303	7,836	8,052
Liab. & shar. funds	134,090	146,590	148,893	154,688	164,225
Total customer deposits	99,807	108,437	106,822	110,059	114,528
Reserve for loan losses	4,052	4,423	4,853	5,418	5,660
Shareholders' equity	20,174	21,271	23,066	23,313	23,821
Profitability/Solvency Ratios (%)					
ROE adjusted	13.2	14.0	13.4	10.1	11.7
Net interest margin	3.25	3.44	3.41	3.23	3.14
Cost/income ratio	50.1	47.5	45.7	50.7	49.7
Cash cost/average assets	2.8	2.6	2.5	2.5	2.5
NPLs/customer loans	7.0	6.5	7.3	7.5	7.2
Reserve for loan losses/NPLs	70.9	70.0	66.4	69.1	70.3
Bad debt prov./avg. cust. loans	0.7	0.6	0.7	0.9	0.6
Loans/deposit ratio	82.0	89.7	93.7	94.9	97.6
Tier 1 capital ratio	17.6	17.0	19.2	18.7	18.1
Total capital ratio	17.6	17.0	19.2	18.7	18.1

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Pekao Financials

Changes in Estimates

Figure 54. Pekao – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	4,809	4,783	-0.6%	5,015	4,663	-7.0%	5,431	4,758	-12.4%
Net Fee & Commission Income	2,320	2,248	-3.1%	2,349	2,127	-9.5%	2,525	2,325	-7.9%
Financial Income	67	408	505.5%	142	142	0.0%	142	142	0.0%
Other Income	691	591	-14.4%	661	612	-7.3%	707	654	-7.4%
Total Revenue	7,887	8,030	1.8%	8,167	7,545	-7.6%	8,804	7,879	-10.5%
Labour Costs	-1,960	-1,925	-1.8%	-1,998	-1,927	-3.6%	-2,056	-1,982	-3.6%
General Costs	-1,393	-1,373	-1.4%	-1,526	-1,499	-1.8%	-1,540	-1,512	-1.8%
Depreciation	-378	-373	-1.2%	-407	-397	-2.4%	-430	-419	-2.4%
Operating Expenses	-3,731	-3,672	-1.6%	-3,931	-3,823	-2.8%	-4,025	-3,914	-2.8%
Operating Profit	4,156	4,359	4.9%	4,236	3,722	-12.1%	4,779	3,965	-17.0%
Provision Charge	-750	-711	-5.2%	-908	-874	-3.7%	-655	-613	-6.3%
Share of Profits (Losses) of Companies Consolidated by Equity Accounting	54	52	-3.7%	68	63	-6.9%	82	76	-6.9%
Profit Before Tax	3,460	3,700	6.9%	3,396	2,911	-14.3%	4,206	3,428	-18.5%
Tax	-663	-715	7.8%	-645	-553	-14.3%	-799	-651	-18.5%
Profit After Tax	2,797	2,985	6.7%	2,751	2,358	-14.3%	3,407	2,777	-18.5%
Extraordinary items	0	0	na	0	0	na	0	0	na
Minorities	-10	-10	-6.8%	-12	-12	0.0%	-12	-12	0.0%
Net Profit	2,787	2,975	6.8%	2,739	2,346	-14.4%	3,395	2,765	-18.6%
EPS (ZI)	10.6	11.3	6.8%	10.4	8.9	-14.4%	12.9	10.5	-18.6%
DPS (ZI)	8.6	8.0	-7.0%	8.6	8.6	0.0%	10.0	10.0	0.0%
Average Diluted Number of Shares (m)	262.5	262.5	0.0%	262.5	262.5	0.0%	262.5	262.5	0.0%

Source: Citi Research

Figure 55. Pekao – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	5,131	5,131	0.0%	5,387	5,387	0.0%	5,656	5,656	0.0%
Interbank placements	5,865	5,865	0.0%	6,159	6,159	0.0%	6,467	6,467	0.0%
Financial Assets & Securities	33,678	32,234	-4.3%	34,914	33,174	-5.0%	36,194	34,382	-5.0%
Net client lending	97,331	95,194	-2.2%	104,838	99,059	-5.5%	113,480	106,174	-6.4%
Fixed assets	1,844	1,844	0.0%	1,918	1,918	0.0%	1,994	1,994	0.0%
Other assets	8,944	8,625	-3.6%	9,527	8,992	-5.6%	10,180	9,551	-6.2%
Total Assets	152,792	148,893	-2.6%	162,742	154,688	-4.9%	173,970	164,225	-5.6%
Interbank borrowing	4,795	4,795	0.0%	5,275	5,275	0.0%	5,802	5,802	0.0%
Client deposits	111,065	106,822	-3.8%	119,042	110,059	-7.5%	127,592	114,528	-10.2%
Other liabilities	13,981	14,118	1.0%	14,979	15,938	6.4%	15,980	19,957	24.9%
Minorities	93	92	-0.8%	105	104	-0.7%	117	116	-0.6%
Equity (ex Minorities)	22,858	23,066	0.9%	23,341	23,313	-0.1%	24,479	23,821	-2.7%
Total liabilities & Equity	152,792	148,893	-2.6%	162,742	154,688	-4.9%	173,970	164,225	-5.6%
BVPS (ZI)	87	88	0.9%	89	89	-0.1%	93	91	-2.7%

Source: Citi Research

Figure 56. Pekao – Changes in Key Ratios Estimates, 2012E-2014E (Polish Zloty in million)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	3.39%	3.41%	3.35%	3.23%	3.40%	3.14%
NIM on Total Ave. Assets	3.21%	3.24%	3.18%	3.07%	3.23%	2.98%
Net Fee & Commission Income/Total Income	29.4%	28.0%	28.8%	28.2%	28.7%	29.5%
Net Fee & Commission Income/Deposits	2.09%	2.10%	1.97%	1.93%	1.98%	2.03%
Cost/Income	47.3%	45.7%	48.1%	50.7%	45.7%	49.7%
Cost/Avg. Assets	2.49%	2.49%	2.49%	2.52%	2.39%	2.45%
Effective tax rate	19.2%	19.3%	19.0%	19.0%	19.0%	19.0%
Dividend Payout Ratio	81.0%	70.6%	82.4%	96.2%	77.3%	94.9%
Provisions/Avg Net Loans	0.79%	0.76%	0.90%	0.90%	0.60%	0.60%
Equity/Assets	15.0%	15.6%	14.4%	15.1%	14.1%	14.6%
Loans/Deposits	87.6%	89.1%	88.1%	90.0%	88.9%	92.7%
Loans/Total Assets	63.7%	63.9%	64.4%	64.0%	65.2%	64.7%
ROE	12.6%	13.4%	11.9%	10.1%	14.2%	11.7%
ROA	1.86%	2.01%	1.74%	1.55%	2.02%	1.73%
NPLs/Total Loans	7.3%	7.3%	7.5%	7.5%	6.5%	7.2%
Provision Coverage of NPLs	65.6%	66.4%	66.3%	69.1%	74.5%	70.3%
RWA/Total Assets	71.0%	70.0%	71.0%	70.0%	71.0%	70.0%
Tier 1 Ratio	19.0%	19.2%	18.3%	18.7%	18.1%	18.1%
Group Employees	20,013	19,783	19,814	19,585	19,814	19,585

Source: Citi Research

Financials

Figure 57. Pekao – Income Statement, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	2,718	4,509	65.9%	3,802	-15.7%	4,104	7.9%	4,558	11.1%	4,783	4.9%	4,663	-2.5%	4,758	2.0%
Net Fee & Commission Income	2,161	2,342	8.3%	2,289	-2.3%	2,368	3.5%	2,449	3.4%	2,248	-8.2%	2,127	-5.4%	2,325	9.3%
Financial Income	390	649	66.5%	827	27.6%	754	-8.8%	589	-21.9%	878	49.0%	654	-25.5%	696	6.5%
Other Income	89	351	295.8%	242	-31.3%	66	-72.5%	150	125.7%	121	-19.1%	100	-17.6%	100	0.0%
Total Revenue	5,358	7,851	46.5%	7,160	-8.8%	7,293	1.9%	7,746	6.2%	8,030	3.7%	7,545	-6.0%	7,879	4.4%
Labour Costs	-1,397	-1,875	34.1%	-1,856	-1.0%	-1,950	5.1%	-1,946	-0.2%	-1,925	-1.1%	-1,927	0.1%	-1,982	2.9%
General Costs	-1,000	-1,513	51.3%	-1,388	-8.2%	-1,314	-5.3%	-1,355	3.1%	-1,373	1.3%	-1,499	9.2%	-1,512	0.9%
Depreciation	-339	-414	22.2%	-441	6.6%	-392	-11.3%	-377	-3.6%	-373	-1.1%	-397	6.3%	-419	5.6%
Operating Expenses	-2,737	-3,802	38.9%	-3,686	-3.0%	-3,656	-0.8%	-3,679	0.6%	-3,672	-0.2%	-3,823	4.1%	-3,914	2.4%
Operating Profit	2,621	4,050	54.5%	3,474	-14.2%	3,636	4.7%	4,067	11.8%	4,359	7.2%	3,722	-14.6%	3,965	3.6%
Provision Charge	-192	-263	36.7%	-535	103.3%	-589	10.1%	-544	-7.6%	-711	30.8%	-874	22.9%	-613	-29.8%
Associate Income	153	123	-19.5%	58	-52.8%	68	17.6%	70	2.5%	52	-25.1%	63	20.0%	76	21.6%
Profit Before Tax	2,582	3,910	51.4%	2,997	-23.3%	3,116	3.9%	3,593	15.3%	3,700	3.0%	2,911	-21.3%	3,428	13.7%
Tax	-438	-722	64.9%	-576	-20.2%	-571	-0.9%	-684	19.7%	-715	4.6%	-553	-22.7%	-651	17.8%
Profit After Tax	2,144	3,188	48.7%	2,421	-24.1%	2,545	5.1%	2,909	14.3%	2,985	2.6%	2,358	-21.0%	2,777	12.8%
Extraordinary Income	18	353	na	0	na	0	na	0	na	0	na	0	na	0	na
Minorities	-7	-13	85.3%	-10	-25.9%	-5	-46.9%	-10	89.7%	-10	-0.6%	-12	24.7%	-12	0.0%
Net Profit	2,155	3,528	63.7%	2,412	-31.6%	2,539	5.3%	2,899	14.2%	2,975	2.6%	2,346	-21.2%	2,765	12.9%
Net Profit After Adjustments	2,137	3,175	48.6%	2,412	-24.0%	2,540	5.3%	2,899	14.2%	2,975	2.6%	2,346	-21.2%	2,765	12.9%
EPS (Zl)	12.3	13.5	9.2%	9.2	-31.7%	9.7	5.2%	11.0	14.1%	11.3	2.6%	8.9	-21.2%	10.5	12.9%
DPS (Zl)	9.6	0.0	na	2.9	na	6.8	134.5%	5.4	-20.9%	8.0	48.7%	8.6	7.5%	10.0	16.3%
Average Diluted Number of Shares (m)	175	262	49.9%	262	0.1%	262	0.0%	262	0.0%	262	0.0%	262	0.0%	262	0.0%

Source: Company reports, Citi Research estimates

Figure 58. Pekao – Balance Sheet, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	5,122	9,934	93.9%	9,620	-3.2%	5,969	-38.0%	4,886	-18.1%	5,131	5.0%	5,387	5.0%	5,656	5.0%
Interbank placements	16,960	7,909	-53.4%	7,203	-8.9%	6,259	-13.1%	5,586	-10.7%	5,865	5.0%	6,159	5.0%	6,467	5.0%
Financial Assets & Securities	26,527	27,185	2.5%	29,917	10.1%	33,197	11.0%	32,535	-2.0%	32,234	-0.9%	33,174	2.9%	34,382	3.6%
Net client lending	66,658	79,078	18.6%	76,380	-3.4%	77,804	1.9%	92,816	19.3%	95,194	2.6%	99,059	4.1%	106,174	7.2%
Fixed assets	2,021	1,906	-5.7%	1,822	-4.4%	1,822	0.0%	1,773	-2.7%	1,844	4.0%	1,918	4.0%	1,994	4.0%
Other assets	6,808	5,929	-12.9%	5,673	-4.3%	9,040	59.3%	8,994	-0.5%	8,625	-4.1%	8,992	4.3%	9,551	6.2%
Total Assets	124,096	131,941	6.3%	130,616	-1.0%	134,090	2.7%	146,590	9.3%	148,893	1.6%	154,688	3.9%	164,225	6.2%
Interbank borrowing	9,942	14,993	50.8%	8,479	-43.4%	7,641	-9.9%	5,901	-22.8%	4,795	-18.7%	5,275	10.0%	5,802	10.0%
Client deposits	89,944	90,889	1.1%	97,250	7.0%	99,807	2.6%	108,437	8.6%	106,822	-1.5%	110,059	3.0%	114,528	4.1%
Other liabilities	9,463	10,022	5.9%	6,516	-35.0%	6,385	-2.0%	10,896	70.7%	14,118	29.6%	15,938	12.9%	19,957	25.2%
Minorities	81	89	10.7%	83	-6.8%	83	-0.2%	85	3.1%	92	8.0%	104	13.0%	116	11.5%
Equity (ex Minorities)	14,667	15,947	8.7%	18,288	14.7%	20,174	10.3%	21,271	5.4%	23,066	8.4%	23,313	1.1%	23,821	2.2%
Total liabilities & Equity	124,096	131,941	6.3%	130,616	-1.0%	134,090	2.7%	146,590	9.3%	148,893	1.6%	154,688	3.9%	164,225	6.2%
Interest Earning Assets	72,737	127,613	75.4%	126,224	-1.1%	126,267	0.0%	138,686	9.8%	141,430	2.0%	146,935	3.9%	155,993	6.2%
BVPS (Zl)	56	61	8.6%	70	14.7%	77	10.2%	81	5.4%	88	8.4%	89	1.1%	91	2.2%

Source: Company reports, Citi Research estimates

Figure 59. Pekao – Key Ratios, 2007-2014E (Percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	3.96%	3.67%	3.00%	3.25%	3.44%	3.41%	3.23%	3.14%
NIM on Total Average Assets	3.66%	3.52%	2.90%	3.10%	3.25%	3.24%	3.07%	2.98%
Net Fee & Commission Income/Total Income	40.3%	29.8%	32.0%	32.5%	31.6%	28.0%	28.2%	29.5%
Net Fee & Commission Income/Deposits	2.4%	2.6%	2.4%	2.4%	2.3%	2.1%	1.9%	2.0%
Cost/Income	51.1%	48.4%	51.5%	50.1%	47.5%	45.7%	50.7%	49.7%
Cost/Avg. Assets	3.69%	2.97%	2.81%	2.76%	2.62%	2.49%	2.52%	2.45%
Effective tax rate	16.9%	18.5%	19.2%	18.3%	19.0%	19.3%	19.0%	19.0%
Dividend Payout Ratio	116.8%	0.0%	31.5%	70.3%	48.7%	70.6%	96.2%	94.9%
Provisions/Avg Net Loans	0.52%	0.36%	0.69%	0.76%	0.64%	0.76%	0.90%	0.60%
Equity/Assets	11.9%	12.2%	14.1%	15.1%	14.6%	15.6%	15.1%	14.6%
Loans/Deposits	74.1%	87.0%	78.5%	78.0%	85.6%	89.1%	90.0%	92.7%
Loans/Total Assets	53.7%	59.9%	58.5%	58.0%	63.3%	63.9%	64.0%	64.7%
ROE	22.9%	23.0%	14.1%	13.2%	14.0%	13.4%	10.1%	11.7%
ROA	2.91%	2.76%	1.84%	1.92%	2.07%	2.01%	1.55%	1.73%
NPLs/Total Loans	7.8%	5.5%	6.8%	6.7%	6.3%	7.3%	7.5%	7.2%
Provision Coverage of NPLs	84.1%	87.2%	76.8%	74.1%	73.2%	66.4%	69.1%	70.3%
Tier 1 Ratio (%)	12.1%	12.2%	16.2%	17.6%	17.0%	19.2%	18.7%	18.1%
Group Employees	22,926	21,992	20,874	20,783	20,357	19,783	19,585	19,585

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Buy	1
Price (29 Nov 12)	ZL237.20
Target price	ZL266.00
from ZL263.00	
Expected share price return	12.1%
Expected dividend yield	6.1%
Expected total return	18.2%
Market Cap	ZL17,704M
	US\$5,586M

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



Bank Zachodni WBK (BZW.WA) Merger Will Help to Offset Macro Headwinds – Maintaining Buy

- **Buy** — We lower our assumption of sustainable ROE after the merger (16%) but due to a lower cost of equity we raise our target price (based on post-merger valuation) to ZL 266 from ZL 263 previously. We maintain our Buy rating on the stock. BZ WBK and Kredyt Bank are now our only Buy-rated Polish banks. We think that the prepared merger of these two banks, leading to increased economies of scale, will help to offset the negative impact of lower economic growth and unfavorable regulations.
- **3Q12 In Line** — The bank reported a 3Q12 net profit of ZL 335m (-3% yoy, -12% qoq, +3% vs. Citi estimates and +2% vs. consensus as reported by PAP). Net interest income and administrative costs were in line with expectations while net fees and provisioning came in slightly better than anticipated (+2% and -1%, respectively, vs. consensus).
- **Management Guidance** — Management expects pressure on NIM (due to declining interest rates) and a flat/slightly higher yoy cost of risk and declares a continued focus on cost control. It expects merger approval by the end of 2012 and sees no risk to Santander's estimate of revenue and cost synergies post-merger.
- **2013E Estimates Revised** — Lower NIM assumptions (3.85% vs. 3.91% in 2013E and 3.77% vs. 3.90% in 2014E) are the main drivers of our EPS cuts (by 3% and 2%, respectively).
- **Outlook for 4Q12E** — We are looking for ZL 321m (-4% qoq) net profit driven by 2% qoq higher revenues, 3% qoq seasonally higher administrative costs and rising 25% qoq provisioning.
- **Outlook for 2013E** — We expect EPS to decline 13% yoy in 2013E, affected by 7bp lower NIM (12bp lower NIM including FX swaps), 1% yoy lower net fees (+3% yoy excluding the effect of interchange reduction), 3% yoy higher administrative costs (flat assuming lack of bank levy and 16% higher provisioning).

Bank Zachodni WBK (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	974.2	1,184.3	1,350.1	1,182.0	1,415.9
Diluted EPS (ZL)	13.25	16.11	18.18	15.75	18.87
Diluted EPS (Old) (ZL)	13.25	16.11	17.66	16.19	19.30
PE (x)	17.9	14.7	13.0	15.1	12.6
P/BV (x)	2.6	2.4	2.0	2.0	1.9
DPS (ZL)	8.00	8.00	14.47	12.67	15.18
Net Div Yield (%)	3.4	3.4	6.1	5.3	6.4
ROE (%)	15.5	16.9	16.9	13.6	15.8

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	17.9	14.7	13.0	15.1	12.6
P/E reported (x)	17.9	14.7	13.0	15.1	12.6
P/BV (x)	2.6	2.4	2.0	2.0	1.9
P/Adjusted BV diluted (x)	2.6	2.4	2.1	2.0	1.9
Dividend yield (%)	3.4	3.4	6.1	5.3	6.4
Per Share Data (ZL)					
EPS adjusted	13.25	16.11	18.18	15.75	18.87
EPS reported	13.25	16.11	18.18	15.75	18.87
BVPS	90.63	100.66	115.72	117.09	123.39
Tangible BVPS	88.27	98.59	113.47	114.59	120.61
Adjusted BVPS diluted	90.07	100.11	115.10	116.46	122.73
DPS	8.00	8.00	14.47	12.67	15.18
Profit & Loss (ZLm)					
Net interest income	1,822	2,069	2,297	2,357	2,473
Fees and commissions	1,345	1,358	1,376	1,366	1,497
Other operating Income	336	347	324	210	220
Total operating income	3,503	3,773	3,997	3,933	4,189
Total operating expenses	-1,729	-1,875	-1,791	-1,843	-1,896
Oper. profit bef. provisions	1,773	1,898	2,207	2,090	2,293
Bad debt provisions	-421	-367	-493	-571	-459
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	1,353	1,531	1,714	1,519	1,834
Tax	-317	-316	-349	-311	-376
Extraord./Min. Int./Pref. Div.	-62	-31	-15	-26	-42
Attributable profit	974	1,184	1,350	1,182	1,416
Adjusted earnings	974	1,184	1,350	1,182	1,416
Growth Rates (%)					
EPS adjusted	9.9	21.6	12.8	-13.4	19.8
Oper. profit bef. prov.	7.9	7.0	16.2	-5.3	9.7
Balance Sheet (ZLm)					
Total assets	53,154	59,797	60,881	65,105	69,644
Avg interest earning assets	52,084	54,881	58,677	61,272	65,534
Customer loans	34,246	39,432	42,258	45,777	49,428
Gross NPLs	2,374	2,179	2,409	2,655	2,719
Liab. & shar. funds	53,154	59,797	60,881	65,105	69,644
Total customer deposits	41,970	46,829	47,558	51,478	55,721
Reserve for loan losses	1,408	1,415	1,530	1,693	1,709
Shareholders' equity	6,623	7,356	8,637	8,739	9,209
Profitability/Solvency Ratios (%)					
ROE adjusted	15.5	16.9	16.9	13.6	15.8
Net interest margin	3.50	3.77	3.91	3.85	3.77
Cost/income ratio	49.4	49.7	44.8	46.9	45.3
Cash cost/average assets	3.2	3.3	3.0	2.9	2.8
NPLs/customer loans	6.9	5.5	5.7	5.8	5.5
Reserve for loan losses/NPLs	59.3	65.0	63.5	63.8	62.9
Bad debt prov./avg. cust. loans	1.2	1.0	1.2	1.3	1.0
Loans/deposit ratio	81.6	84.2	88.9	88.9	88.7
Tier 1 capital ratio	13.8	13.2	14.6	12.6	12.4
Total capital ratio	15.8	15.1	16.3	14.3	14.0

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BZ WBK Financials

Changes in Estimates

Figure 60. BZ WBK – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty In million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	2,305.3	2,296.5	-0.4%	2,419.6	2,357.2	-2.6%	2,578.9	2,473.2	-4.1%
Net Fee & Commission Income	1,374.4	1,376.3	0.1%	1,389.9	1,366.0	-1.7%	1,493.6	1,496.6	0.2%
Financial Income	167.8	213.8	27%	94.9	125.2	31.9%	80.1	129.5	61.7%
Other Income	96.0	110.6	15.1%	85.0	85.0	0.0%	90.0	90.0	0.0%
Total Revenue	3,943.6	3,997.3	1.4%	3,989.4	3,933.4	-1.4%	4,242.6	4,189.4	-1.3%
Labour Costs	-959.3	-947.8	-1.2%	-972.1	-939.8	-3.3%	-997.5	-964.3	-3.3%
General Costs	-696.7	-703.9	1.0%	-747.8	-762.3	1.9%	-767.6	-785.0	2.3%
Depreciation	-138.1	-138.8	0.5%	-139.8	-141.3	1.0%	-145.5	-147.0	1.0%
Operating Expenses	-1,794.1	-1,790.6	-0.2%	-1,859.7	-1,843.3	-0.9%	-1,910.5	-1,896.3	-0.7%
Operating Profit	2,149.5	2,206.7	2.7%	2,129.7	2,090.2	-1.9%	2,332.0	2,293.1	-1.7%
Provision Charge	-474.8	-492.6	3.7%	-568.7	-570.9	0.4%	-457.0	-458.8	0.4%
Associate Income	10.2	14.2	38.6%	8.0	8.0	0.0%	8.0	8.0	0.0%
Profit Before Tax	1,684.9	1,728.3	2.6%	1,569.0	1,527.2	-2.7%	1,883.1	1,842.3	-2.2%
Minorities	-27.5	-29.5	7.4%	-34.0	-34.0	0.0%	-50.0	-50.0	0.0%
Tax	-345.8	-348.7	0.8%	-320.0	-311.3	-2.7%	-384.9	-376.4	-2.2%
Net Profit	1,311.6	1,350.1	2.9%	1,214.9	1,182.0	-2.7%	1,448.1	1,415.9	-2.2%
EPS (Zl)	17.7	18.2	2.9%	16.2	15.8	-2.7%	19.3	18.9	-2.2%
DPS (Zl)	14.1	14.5	2.9%	13.0	12.7	-2.7%	15.5	15.2	-2.2%
Average Diluted Number of Shares (m)	74.3	74.3	0.0%	75.0	75.0	0.0%	75.0	75.0	0.0%

Source: Citi Research

Figure 61. BZ WBK – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty In million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	1,584	1,584	0.0%	1,759	1,759	0.0%	1,954	1,954	0.0%
Interbank placements	1,382	1,338	-3.2%	1,535	1,486	-3.2%	1,706	1,651	-3.2%
Financial Assets & Securities	16,276	15,570	-4.3%	16,729	15,996	-4.4%	17,177	16,418	-4.4%
Net client lending	40,567	40,727	0.4%	43,911	44,085	0.4%	47,530	47,719	0.4%
Fixed assets	555	555	0.0%	617	617	0.0%	685	685	0.0%
Other assets	976	1,108	13.5%	1,020	1,162	13.8%	1,066	1,217	14.2%
Total Assets	61,341	60,881	-0.7%	65,572	65,105	-0.7%	70,118	69,644	-0.7%
Interbank borrowing	3,068	3,006	-2.0%	2,853	2,796	-2.0%	2,283	2,237	-2.0%
Client deposits	46,418	47,558	2.5%	50,244	51,478	2.5%	54,386	55,721	2.5%
Other liabilities	3,205	1,586	-50.5%	3,625	1,964	-45.8%	4,074	2,299	-43.6%
Minorities	92	94	1.9%	126	128	1.4%	176	178	1.0%
Equity (ex Minorities)	8,557	8,637	0.9%	8,723	8,739	0.2%	9,199	9,209	0.1%
Total liabilities & Equity	61,341	60,881	-0.7%	65,572	65,105	-0.7%	70,118	69,644	-0.7%
Interest Earning Assets	59,809	59,218	-1.0%	63,934	63,326	-1.0%	68,367	67,741	-0.9%
Risk Weighted Assets	50,913	50,531	-0.7%	54,424	54,037	-0.7%	58,198	57,805	-0.7%
BVPS (Zl)	115	116	0.9%	117	117	0.2%	123	123	0.1%

Source: Citi Research

Figure 62. BZ WBK – Changes in Key Ratios Estimates, 2012E-2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	4.03%	3.91%	3.91%	3.85%	3.90%	3.77%
NIM on Total Ave. Assets	3.80%	3.81%	3.81%	3.74%	3.80%	3.67%
Net Fee & Commission Income/Total Income	34.9%	34.4%	34.8%	34.7%	35.2%	35.7%
Net Fee & Commission Income/Deposits	3.0%	2.9%	2.8%	2.7%	2.7%	2.7%
Cost/Income	45.5%	44.8%	46.6%	46.9%	45.0%	45.3%
Cost/Avg. Assets	3.0%	3.0%	2.9%	2.9%	2.8%	2.8%
Effective tax rate	20.5%	20.2%	20.4%	20.4%	20.4%	20.4%
Dividend Payout Ratio	80.0%	80.0%	80.0%	80.0%	80.0%	80.0%
Provisions/Avg Net Loans	1.21%	1.25%	1.35%	1.35%	1.00%	1.00%
Equity/Assets	14.1%	14.3%	13.5%	13.6%	13.4%	13.5%
Loans/Deposits	87.4%	85.6%	87.4%	85.6%	87.4%	85.6%
Loans/Total Assets	66.1%	66.9%	67.0%	67.7%	67.8%	68.5%
ROE	16.5%	16.9%	14.1%	13.6%	16.2%	15.8%
ROA	2.16%	2.24%	1.91%	1.88%	2.13%	2.10%
NPLs/Total Loans	5.8%	5.7%	5.8%	5.8%	5.0%	5.5%
Provision Coverage of NPLs	62.0%	63.5%	63.4%	63.8%	68.8%	62.9%
RWA/Total Assets	83.0%	83.0%	83.0%	83.0%	83.0%	83.0%
CAR	16.1%	16.3%	16.1%	14.3%	15.8%	14.0%
Group Employees	8,937	8,690	8,937	8,690	8,937	8,690

Source: Citi Research

Financials

Figure 63. BZ WBK – Income Statement, 2007-2014E (Polish Zloty In million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	1,287	1,635	27.1%	1,563	-4.4%	1,822	16.6%	2,069	13.5%	2,297	11.0%	2,357	2.6%	2,473	4.9%
Net Fee & Commission Income	1,545	1,390	-10.1%	1,315	-5.3%	1,345	2.2%	1,358	1.0%	1,376	1.4%	1,366	-0.8%	1,497	9.6%
Financial Income	44	95	114.8%	264	178.4%	271	2.6%	279	2.8%	214	-23.3%	125	-41.4%	130	3.4%
Other Income	79	111	40.7%	123	11.4%	65	-47.4%	68	5.1%	111	62.1%	85	-23.1%	90	5.9%
Total Revenue	2,955	3,230	9.3%	3,266	1.1%	3,503	7.2%	3,773	7.7%	3,997	5.9%	3,933	-1.6%	4,189	6.5%
Labour Costs	-843	-896	6.4%	-889	-0.8%	-959	7.8%	-977	1.9%	-948	-3.0%	-940	-0.8%	-964	2.6%
General Costs	-582	-651	11.8%	-609	-6.4%	-642	5.4%	-682	6.3%	-704	3.2%	-762	8.3%	-785	3.0%
Depreciation	-135	-107	-20.3%	-123	15.0%	-129	4.3%	-216	67.6%	-139	-35.7%	-141	1.7%	-147	4.1%
Operating Expenses	-1,559	-1,655	6.1%	-1,622	-2.0%	-1,729	6.6%	-1,875	8.4%	-1,791	-4.5%	-1,843	2.9%	-1,896	2.9%
Operating Profit	1,395	1,576	12.9%	1,644	4.3%	1,773	7.9%	1,898	7.0%	2,207	16.2%	2,090	-5.3%	2,293	9.7%
Provision Charge	-4	-365	9162%	-481	32.0%	-421	-12.5%	-367	-12.8%	-493	34.2%	-571	15.9%	-459	-19.6%
Associate Income	0	-1	na	0	-57.0%	4	na	11	149.4%	14	27.8%	8	-43.6%	8	0.0%
Profit Before Tax	1,391	1,211	-13.0%	1,163	-3.9%	1,357	16.7%	1,542	13.6%	1,728	12.1%	1,527	-11.6%	1,842	20.6%
Minorities	-156	-99	-36.6%	-54	-45.4%	-66	22.9%	-43	-35.9%	-30	-30.5%	-34	15.1%	-50	47.1%
Tax	-281	-256	-8.7%	-223	-13.1%	-317	42.1%	-316	-0.3%	-349	10.5%	-311	-10.7%	-376	20.9%
Net Profit	955	855	-10.4%	886	3.6%	974	9.9%	1,184	21.6%	1,350	14.0%	1,182	-12.5%	1,416	19.8%
EPS (Zl)	13.1	11.7	-10.7%	12.1	3.3%	13.2	9.9%	16.1	21.6%	18.2	12.8%	15.8	-13.4%	18.9	19.8%
DPS (Zl)	3.00	0.00	na	4.00	na	8.00	100.0%	8.00	0.0%	14.47	80.9%	12.67	-12.5%	15.18	19.8%
Average Diluted Number of Shares (m)	73.1	73.3	0.3%	73.5	0.3%	73.5	0.0%	73.5	0.0%	74.3	1.0%	75.0	1.1%	75.0	0.0%

Source: Company reports, Citi Research estimates

Figure 64. BZ WBK – Balance Sheet, 2007-2014E (Polish Zloty In million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	2,206	3,178	44.0%	2,661	-16.3%	2,534	-4.7%	1,426	-43.8%	1,584	11.1%	1,759	11.1%	1,954	11.1%
Interbank placements	2,577	1,365	-47.0%	663	-51.4%	620	-6.5%	1,204	94.3%	1,338	11.1%	1,486	11.1%	1,651	11.1%
Financial Assets & Securities	11,063	16,141	45.9%	14,646	-9.3%	15,649	6.8%	17,630	12.7%	15,570	-11.7%	15,996	2.7%	16,418	2.6%
Net client lending	23,950	35,137	46.7%	34,571	-1.6%	32,838	-5.0%	38,017	15.8%	40,727	7.1%	44,085	8.2%	47,719	8.2%
Fixed assets	543	637	17.4%	596	-6.5%	548	-8.2%	500	-8.7%	555	11.1%	617	11.1%	685	11.1%
Other assets	993	974	-1.8%	922	-5.4%	965	4.7%	1,020	5.7%	1,108	8.6%	1,162	4.9%	1,217	4.8%
Total Assets	41,332	57,433	39.0%	54,058	-5.9%	53,154	-1.7%	59,797	12.5%	60,881	1.8%	65,105	6.9%	69,644	7.0%
Interbank borrowing	4,484	5,338	19.1%	5,350	0.2%	2,526	-52.8%	2,505	-0.8%	3,006	20.0%	2,796	-7.0%	2,237	-20.0%
Client deposits	29,766	42,811	43.8%	41,223	-3.7%	41,970	1.8%	46,829	11.6%	47,558	1.6%	51,478	8.2%	55,721	8.2%
Other liabilities	2,506	4,072	62.5%	1,430	-64.9%	1,884	31.7%	2,979	58.1%	1,586	-46.8%	1,964	23.8%	2,299	17.0%
Minorities	235	240	2.0%	108	-54.8%	151	38.9%	127	-15.4%	94	-26.1%	128	36.1%	178	39.0%
Equity (ex Minorities)	4,342	4,973	14.5%	5,947	19.6%	6,623	11.4%	7,356	11.1%	8,637	17.4%	8,739	1.2%	9,209	5.4%
Total liabilities & Equity	41,332	57,433	39.0%	54,058	-5.9%	53,154	-1.7%	59,797	12.5%	60,881	1.8%	65,105	6.9%	69,644	7.0%
BVPS (Zl)	60	68	14.5%	81	19.4%	91	11.4%	101	11.1%	116	15.0%	117	1.2%	123	5.4%

Source: Company reports, Citi Research estimates

Figure 65. BZ WBK – Key Ratios, 2007-2014E (Percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	3.61%	3.42%	2.89%	3.50%	3.77%	3.91%	3.85%	3.77%
NIM on Total Ave. Assets	3.46%	3.31%	2.80%	3.40%	3.66%	3.81%	3.74%	3.67%
Net Fee & Commission Income/Total Income	52.3%	43.0%	40.3%	38.4%	36.0%	34.4%	34.7%	35.7%
Net Fee & Commission Income/Deposits	5.2%	3.2%	3.2%	3.2%	2.9%	2.9%	2.7%	2.7%
Cost/Income	52.8%	51.2%	49.7%	49.4%	49.7%	44.8%	46.9%	45.3%
Cost/Avg. Assets	4.2%	3.4%	2.9%	3.2%	3.3%	3.0%	2.9%	2.8%
Effective tax rate	20.2%	21.2%	19.2%	23.3%	20.5%	20.2%	20.4%	20.4%
Dividend Payout Ratio	22.9%	0.0%	33.0%	60.0%	49.4%	80.0%	80.0%	80.0%
Provisions/Avg Net Loans	0.02%	1.23%	1.38%	1.25%	1.04%	1.25%	1.35%	1.00%
Equity/Assets	11.1%	9.1%	11.2%	12.7%	12.5%	14.3%	13.6%	13.5%
Loans/Deposits	80.5%	82.1%	83.9%	78.2%	81.2%	85.6%	85.6%	85.6%
Loans/Total Assets	57.9%	61.2%	64.0%	61.8%	63.6%	66.9%	67.7%	68.5%
ROE	23.0%	18.4%	16.2%	15.5%	16.9%	16.9%	13.6%	15.8%
ROA	2.57%	1.73%	1.59%	1.82%	2.10%	2.24%	1.88%	2.10%
NPLs/Total Loans	2.8%	2.9%	5.5%	6.9%	5.5%	5.7%	5.8%	5.5%
Provision Coverage of NPLs	85.2%	85.7%	58.2%	59.3%	65.0%	63.5%	63.8%	62.9%
RWA/Total Assets	68.9%	76.9%	77.1%	74.5%	77.3%	83.0%	83.0%	83.0%
CAR	13.3%	10.7%	13.0%	15.8%	15.1%	16.3%	14.3%	14.0%
Group Employees	9,086	10,221	9,453	9,840	9,383	8,690	8,690	8,690

Source: Company reports, Citi Research estimates

BZ WBK – Kredyt Bank - Pro-Forma Forecasts

Figure 66. BZ WBK – Kredyt Bank – Pro Forma Income Statement, 2010-2015E (Polish Zloty in million)

	2010	2011	Yoy	2012E	Yoy	2013E	Yoy	2014E	Yoy	2015E	Yoy
Net Interest Income	2,950	3,219	9.1%	3,086	-4.1%	3,159	2.4%	3,529	11.7%	3,708	5.1%
Net Fee & Commission Income	1,675	1,673	-0.1%	1,717	2.6%	1,701	-0.9%	1,871	9.9%	1,967	5.2%
Financial Income	-338	324	na	470	44.8%	365	-22.2%	368	0.7%	345	-6.2%
Other Income	848	183	-78.4%	226	23.1%	181	-19.8%	188	3.8%	205	9.2%
Total Revenue	5,134	5,399	5.1%	5,498	1.8%	5,407	-1.7%	5,854	8.3%	6,225	6.3%
Labour Costs	-1,376	-1,420	3.2%	-1,413	-0.5%	-1,354	-4.2%	-1,330	-1.8%	-1,328	-0.2%
General Costs	-1,052	-1,149	9.2%	-1,150	0.1%	-1,231	7.0%	-1,218	-1.1%	-1,177	-3.4%
Depreciation	-230	-306	33.0%	-215	-29.8%	-320	49.3%	-209	-34.6%	-206	-1.5%
Operating Expenses	-2,657	-2,875	8.2%	-2,779	-3.3%	-2,906	4.6%	-2,757	-5.1%	-2,711	-1.7%
Operating Profit	2,477	2,524	1.9%	2,719	7.7%	2,501	-8.0%	3,096	23.8%	3,514	13.5%
Provision Charge	-893	-566	-36.6%	-709	25.3%	-1,005	41.8%	-734	-27.0%	-814	10.8%
Associate Income	8	15	96.4%	16	3.4%	9	-43.8%	9	0.0%	10	14.3%
Profit Before Tax	1,592	1,974	24.0%	2,026	2.7%	1,504	-25.8%	2,371	57.7%	2,711	14.3%
Minorities	-66	-43	-35.9%	-30	-30.5%	-34	15.1%	-50	47.1%	-53	6.9%
Tax	-365	-419	14.8%	-435	3.8%	-307	-29.6%	-482	57.1%	-519	7.8%
Net Profit	1,160	1,512	30.3%	1,561	3.3%	1,163	-25.5%	1,840	58.1%	2,138	16.2%
EPS (Zl)	12.6	16.4	30.4%	16.6	1.6%	12.4	-25.5%	19.6	58.1%	22.8	16.2%
DPS (Zl)	0.00	0.00	na	13.35	na	9.95	-25.5%	15.73	58.1%	18.29	16.2%

Source: Company reports, Citi Research estimates

Figure 67. BZ WBK – Kredyt Bank – Pro Forma Balance Sheet, 2010-2015E (Polish Zloty in million)

	2010	2011	Yoy	2012E	Yoy	2013E	Yoy	2014E	Yoy	2015E	Yoy
Cash and NBP Balances	4,478	2,210	-50.6%	2,384	7.9%	2,348	-1.5%	2,983	27.1%	2,975	-0.3%
Interbank placements	2,171	2,392	10.2%	2,550	6.6%	2,722	6.8%	2,912	7.0%	3,120	7.1%
Financial Assets & Securities	27,299	27,541	0.9%	27,204	-1.2%	28,145	3.5%	29,102	3.4%	31,176	7.1%
Net client lending	60,033	67,103	11.8%	69,696	3.9%	71,605	2.7%	75,239	5.1%	80,707	7.3%
Fixed assets	838	760	-9.4%	820	8.0%	887	8.2%	961	8.3%	1,032	7.4%
Other assets	1,709	1,794	5.0%	1,698	-5.3%	1,758	3.5%	1,819	3.5%	1,953	7.3%
Total Assets	96,528	101,800	5.5%	104,352	2.5%	107,464	3.0%	113,016	5.2%	120,964	7.0%
Interbank borrowing	14,905	10,992	-26.3%	10,559	-3.9%	7,918	-25.0%	6,242	-21.2%	5,861	-6.1%
Client deposits	67,631	74,873	10.7%	77,480	3.5%	83,867	8.2%	91,281	8.8%	99,322	8.8%
Other liabilities	4,390	5,387	22.7%	4,244	-21.2%	3,662	-13.7%	2,292	-37.4%	2,056	-10.3%
Minorities	151	127	-15.4%	94	-26.1%	128	36.1%	178	39.0%	232	30.0%
Equity (ex Minorities)	9,451	10,421	10.3%	11,974	14.9%	11,889	-0.7%	13,023	9.5%	13,493	3.6%
Total liabilities & Equity	96,528	101,800	5.5%	104,352	2.5%	107,464	3.0%	113,016	5.2%	120,964	7.0%
BVPS (Zl)	104	114	9.9%	128	12.5%	130	1.5%	138	6.2%	146	5.7%

Source: Company reports, Citi Research estimates

Figure 68. BZ WBK – Kredyt Bank – Pro Forma Key Ratios, 2010-2015E (Percentage)

	2010	2011	2012E	2013E	2014E	2015E
NIM on AIEA	3.30%	3.32%	3.10%	3.08%	3.29%	3.22%
NIM on Total Ave. Assets	3.11%	3.25%	2.99%	2.98%	3.20%	3.17%
Net Fee & Commission Income/Total Income	32.6%	31.0%	31.2%	31.5%	32.0%	31.6%
Net Fee & Commission Income/Deposits	2.5%	2.2%	2.2%	2.0%	2.0%	2.0%
Cost/Income	51.8%	53.2%	50.5%	53.7%	47.1%	43.5%
Cost/Avg. Assets	2.8%	2.9%	2.7%	2.7%	2.5%	2.3%
Effective tax rate	23.0%	21.3%	21.5%	20.4%	20.3%	19.1%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Provisions/Avg Net Loans	1.48%	0.89%	1.04%	1.42%	1.00%	1.04%
Equity/Assets	9.8%	10.2%	11.5%	11.1%	11.5%	11.2%
Loans/Deposits	88.8%	89.6%	90.0%	85.4%	82.4%	81.3%
Loans/Total Assets	62.2%	65.9%	66.8%	66.6%	66.6%	66.7%
ROE	12.9%	15.2%	13.9%	9.8%	14.8%	16.1%
ROA	1.22%	1.52%	1.51%	1.10%	1.67%	1.83%
NPLs/Total Loans	8.1%	6.7%	7.0%	7.0%	6.4%	6.2%
Provision Coverage of NPLs	64.4%	60.2%	58.5%	57.7%	56.7%	56.8%
RWA/Total Assets	41.0%	45.4%	48.4%	50.3%	51.1%	51.6%
CAR	14.4%	14.1%	15.0%	13.5%	13.4%	12.3%

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

Buy	1
<i>from Buy/High Risk</i>	
Price (29 Nov 12)	ZL15.35
Target price	ZL18.50
<i>from ZL18.30</i>	
Expected share price return	20.5%
Expected dividend yield	0.0%
Expected total return	20.5%
Market Cap	ZL4,170M
	US\$1,316M

Price Performance
(RIC: KRB.WA, BB: KRB PW)



Kredyt Bank SA (KRB.WA)

The Merger Day Is Approaching – Changing Rating to Buy

- **Buy** — We continue to value Kredyt Bank on the base of our valuation of the merged bank and the approved share swap parity. Given the increase in our BZW target price, we increase our Kredyt Bank target price to ZL 18.5 from ZL 18.3 previously. Taking into account the comments from KNF (Polish FSA) representatives on possible approval of BZ WBK – Kredyt Bank merger in 4Q12, and the lack of any signals that that schedule is endangered we change our rating to Buy from Buy/High Risk previously.
- **3Q12 Beat** — Kredyt Bank reported a 3Q12 net profit of ZL 110m (+81% yoy, +76% qoq, +80% vs. Citi estimates and 81% vs. consensus as reported by PAP). The earnings beat was caused predominantly by high gains on bonds (ZL 54m) driving financial and other profits (ZL 136m vs. consensus at ZL 98m). But net profit was also positively affected by higher-than-expected net interest income (+2% vs. consensus), lower administrative costs (-6% vs. consensus) and lower provisioning (-12% vs. consensus).
- **We Expect ZL 400m Synergies** — We think Santander will be able to achieve its goal of ZL 322m cost synergies in 2015E by lowering the number of Kredyt Bank branches by one-fifth and reducing headcount by one-third (see [BZ WBK and Kredyt Bank - A Good Marriage: Upgrading BZ WBK and Kredyt Bank to Buy](#)). We are less optimistic on the revenues side but we expect benefits from a lower cost of funding to exceed interest income lost due to branch closures and tougher risk management and estimate revenue synergies at ZL c 48m.
- **Raising EPS Forecasts** — Taking into account reduced administrative costs in 9M12, we lower our estimates of operating expenses by 8% in 2013E and in 2014E. Due to a slower-than-anticipated pace of deterioration in asset quality we decrease 2013E provisions by 12% but increase 2014E provisions by 6%. As a result of these changes, our EPS forecasts increase in both years.
- **16% ROE After the Merger** — We forecast the merged bank to generate a net profit of ZL 2,1384m and to achieve an ROE of 16.1% by 2015. On our pro-forma merged financial forecasts, we estimate that BZ WBK shares trades on a 2015E P/BV of 1.6x and 10.5x earnings, while Kredyt Bank trades at 1.5x and 9.7x, respectively.

Kredyt Bank SA (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	185.9	329.3	312.3	128.7	249.1
Diluted EPS (ZL)	0.68	1.21	1.15	0.47	0.92
Diluted EPS (Old) (ZL)	0.68	1.20	0.78	0.15	0.89
PE (x)	22.4	12.7	13.4	32.4	16.7
P/BV (x)	1.5	1.4	1.2	1.2	1.1
DPS (ZL)	0.37	0.00	0.00	0.00	0.00
Net Div Yield (%)	2.4	0.0	0.0	0.0	0.0
ROE (%)	6.9	11.2	9.5	3.6	6.7

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	22.4	12.7	13.4	32.4	16.7
P/E reported (x)	22.4	12.7	13.4	32.4	16.7
P/BV (x)	1.5	1.4	1.2	1.2	1.1
P/Adjusted BV diluted (x)	1.5	1.4	1.2	1.2	1.1
Dividend yield (%)	2.4	0.0	0.0	0.0	0.0
Per Share Data (ZL)					
EPS adjusted	0.68	1.21	1.15	0.47	0.92
EPS reported	0.68	1.21	1.15	0.47	0.92
BVPS	10.41	11.28	12.84	13.32	14.23
Tangible BVPS	10.23	11.07	12.62	13.09	14.00
Adjusted BVPS diluted	10.41	11.28	12.84	13.32	14.23
DPS	0.37	0.00	0.00	0.00	0.00
Profit & Loss (ZLm)					
Net interest income	1,128	1,150	812	859	928
Fees and commissions	330	315	336	316	332
Other operating Income	174	160	423	304	304
Total operating income	1,632	1,625	1,571	1,479	1,564
Total operating expenses	-912	-983	-941	-923	-934
Oper. profit bef. provisions	720	643	630	556	630
Bad debt provisions	-472	-199	-191	-384	-307
Non-operating/exceptionals	-16	-15	-11	-11	-11
Pre-tax profit	231	429	428	161	311
Tax	-49	-104	-117	-32	-62
Extraord./Min. Int./Pref. Div.	3	4	1	0	0
Attributable profit	186	329	312	129	249
Adjusted earnings	186	329	312	129	249
Growth Rates (%)					
EPS adjusted	438.0	77.1	-5.1	-58.8	93.5
Oper. profit bef. prov.	20.3	-10.7	-1.9	-11.8	13.4
Balance Sheet (ZLm)					
Total assets	43,374	42,003	43,778	45,555	47,405
Avg interest earning assets	40,226	41,655	42,069	44,044	45,832
Customer loans	29,108	30,494	30,342	31,401	32,481
Gross NPLs	2,822	2,512	2,761	2,983	2,923
Liab. & shar. funds	43,374	42,003	43,778	45,555	47,405
Total customer deposits	25,661	28,043	30,049	32,526	35,207
Reserve for loan losses	1,914	1,408	1,399	1,283	1,140
Shareholders' equity	2,828	3,066	3,489	3,617	3,866
Profitability/Solvency Ratios (%)					
ROE adjusted	6.9	11.2	9.5	3.6	6.7
Net interest margin	2.80	2.76	1.93	1.95	2.03
Cost/income ratio	55.9	60.5	59.9	62.4	59.7
Cash cost/average assets	2.2	2.3	2.2	2.1	2.0
NPLs/customer loans	9.7	8.2	9.1	9.5	9.0
Reserve for loan losses/NPLs	67.8	56.0	50.7	43.0	39.0
Bad debt prov./avg. cust. loans	1.7	0.7	0.6	1.2	1.0
Loans/deposit ratio	113.4	108.7	101.0	96.5	92.3
Tier 1 capital ratio	8.9	8.7	9.5	9.5	9.8
Total capital ratio	12.5	12.5	13.1	13.0	13.2

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Kredyt Bank Financials

Changes in Estimates

Figure 69. Kredyt Bank – Changes in Income Statement Estimates, 2012E–2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	789.6	811.9	2.8%	831.0	858.8	3.3%	923.6	928.3	0.5%
Net Fee & Commission Income	340.3	336.0	-1.3%	335.3	316.0	-5.7%	362.9	332.1	-8.5%
Financial Income	255.8	320.7	25.4%	240.1	208.1	-13.3%	238.3	206.3	-13.4%
Other Income	115.1	102.1	-11.2%	95.9	95.9	0.0%	97.7	97.7	0.0%
Total Revenue	1,500.7	1,570.8	4.7%	1,502.3	1,478.8	-1.6%	1,622.5	1,564.4	-3.6%
Labour Costs	-465.6	-452.9	-2.7%	-464.7	-430.3	-7.4%	-465.6	-431.2	-7.4%
General Costs	-446.5	-428.9	-4.0%	-473.9	-436.2	-7.9%	-482.8	-444.3	-8.0%
Depreciation	-75.8	-70.3	-7.3%	-79.2	-67.5	-14.9%	-82.5	-70.2	-14.9%
Operating Expenses	-988.0	-952.1	-3.6%	-1,017.8	-934.0	-8.2%	-1,030.9	-945.7	-8.3%
Operating Profit	512.7	618.7	20.7%	484.5	544.8	12.4%	591.6	618.7	4.6%
Provision Charge	-216.4	-190.6	-11.9%	-434.5	-383.8	-11.7%	-289.7	-307.3	6.1%
Share of Profits (Losses) of Companies Consolidated by Equity Accounting	1.4	1.0	-27.0%	0.8	0.0	na	0.8	0.0	na
Profit Before Tax	297.7	429.2	44.2%	50.7	160.9	217.2%	302.6	311.4	2.9%
Minorities and discontinued operations	0.0	0.0	na	0.0	0.0	na	0.0	0.0	na
Tax	-86.6	-116.8	34.8%	-10.1	-32.2	217.2%	-59.9	-62.3	3.9%
Net Profit	211.1	312.3	48.0%	40.6	128.7	217.2%	242.7	249.1	2.7%
EPS (Zl)	0.8	1.1	48.0%	0.1	0.5	217.2%	0.9	0.9	2.7%
DPS (Zl)	0.0	0.0	na	0.0	0.0	na	0.0	0.0	na
Average Diluted Number of Shares (m)	271.7	271.7	0.0%	271.7	271.7	0.0%	271.7	271.7	0.0%

Source: Citi Research

Figure 70. Kredyt Bank – Changes in Balance Sheet Estimates, 2012E – 2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	800	800	0.0%	817	817	0.0%	833	833	0.0%
Interbank placements	1,212	1,212	0.0%	1,236	1,236	0.0%	1,261	1,261	0.0%
Financial Assets & Securities	11,635	12,212	5.0%	12,149	12,749	4.9%	12,684	13,309	4.9%
Net client lending	28,968	28,943	-0.1%	28,968	30,118	4.0%	28,968	31,341	8.2%
Fixed assets	265	265	0.0%	270	270	0.0%	276	276	0.0%
Other assets	590	345	-41.5%	596	365	-38.8%	602	385	-36.1%
Total Assets	43,471	43,778	0.7%	44,036	45,555	3.4%	44,624	47,405	6.2%
Interbank borrowing	7,553	7,553	0.0%	6,571	6,571	0.0%	5,454	5,454	0.0%
Client deposits	29,923	30,049	0.4%	32,389	32,526	0.4%	35,059	35,207	0.4%
Other liabilities	2,658	2,687	1.1%	1,698	2,841	67.3%	494	2,878	483.0%
Minorities	0	0	na	0	0	na	0	0	na
Equity (ex Minorities)	3,337	3,489	4.5%	3,378	3,617	7.1%	3,618	3,866	6.9%
Total liabilities & Equity	43,471	43,778	0.7%	44,036	45,555	3.4%	44,624	47,405	6.2%
Risk Weighted Assets	31,299	31,958	2.1%	31,706	33,255	4.9%	32,130	34,606	7.7%
BVPS (Zl)	12.28	12.84	4.5%	12.43	13.32	7.1%	13.32	14.23	6.9%

Source: Citi Research

Figure 71. Kredyt Bank – Changes in Key Ratios Estimates, 2012E – 2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	1.89%	1.93%	1.94%	1.95%	2.13%	2.03%
NIM on Total Ave. Assets	1.85%	1.89%	1.90%	1.92%	2.08%	2.00%
Net Fee & Commission Income/Total Income	22.7%	21.4%	22.3%	21.4%	22.4%	21.2%
Net Fee & Commission Income/Deposits	1.1%	1.1%	1.0%	1.0%	1.0%	0.9%
Cost/Income	65.8%	60.6%	67.7%	63.2%	63.5%	60.5%
Cost/Avg. Assets	2.3%	2.2%	2.3%	2.1%	2.3%	2.0%
Effective tax rate	29.1%	27.2%	20.0%	20.0%	19.8%	20.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Provisions/Avg Net Loans	0.7%	0.7%	1.5%	1.3%	1.0%	1.0%
Equity/Assets	7.7%	8.0%	7.7%	7.9%	8.1%	8.2%
Loans/Deposits	96.8%	96.3%	89.4%	92.6%	82.6%	89.0%
Loans/Total Assets	66.6%	66.1%	65.8%	66.1%	64.9%	66.1%
ROE	6.6%	9.5%	1.2%	3.6%	6.9%	6.7%
ROA	0.49%	0.73%	0.09%	0.29%	0.55%	0.54%
NPLs/Total Loans	8.7%	9.1%	8.7%	9.5%	8.0%	9.0%
Provision Coverage of NPLs	53.9%	50.7%	51.5%	43.0%	49.7%	39.0%
RWA/Total Assets	72.0%	73.0%	72.0%	73.0%	72.0%	73.0%
CAR	12.9%	13.1%	12.8%	13.0%	13.4%	13.2%
Group Employees	4,795	4,520	4,606	4,342	4,514	4,255

Source: Citi Research

Financials

Figure 72. Kredyt Bank – Income Statement, 2007 – 2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	871.5	1,059.9	21.6%	1,061.2	0.1%	1,127.8	6.3%	1,150.1	2.0%	811.9	-29.4%	858.8	5.8%	928.3	8.1%
Net Fee & Commission Income	309.5	293.1	-5.3%	304.1	3.7%	329.9	8.5%	314.9	-4.5%	336.0	6.7%	316.0	-6.0%	332.1	5.1%
Financial Income	47.9	-276.2	na	-176.5	-36.1%	-608.9	245.0%	45.4	na	320.7	606.9%	208.1	-35.1%	206.3	-0.9%
Other Income	216.1	559.1	158.7%	414.3	-25.9%	782.8	89.0%	115.1	-85.3%	102.1	-11.2%	95.9	-6.1%	97.7	1.9%
Total Revenue	1,445.0	1,635.9	13.2%	1,603.1	-2.0%	1,631.6	1.8%	1,625.5	-0.4%	1,570.8	-3.4%	1,478.8	-5.9%	1,564.4	5.8%
Labour Costs	-492.5	-536.2	8.9%	-454.1	-15.3%	-416.7	-8.2%	-443.5	6.4%	-452.9	2.1%	-430.3	-5.0%	-431.2	0.2%
General Costs	-371.4	-464.7	25.1%	-454.7	-2.1%	-410.5	-9.7%	-464.2	13.1%	-428.9	-7.6%	-436.2	1.7%	-444.3	1.9%
Depreciation	-110.7	-103.7	-6.3%	-114.5	10.4%	-101.0	-11.8%	-89.8	-11.1%	-70.3	-21.7%	-67.5	-4.0%	-70.2	4.1%
Operating Expenses	-974.6	-1,105	13.3%	-1,023	-7.4%	-928.1	-9.3%	-997.5	7.5%	-952.1	-4.6%	-934.0	-1.9%	-945.7	1.3%
Operating Profit	470.4	531.3	13.0%	579.8	9.1%	703.5	21.3%	628.0	-10.7%	618.7	-1.5%	544.8	-12.0%	618.7	13.6%
Provision Charge	30.1	-108.2	na	-803.2	642.3%	-472.0	-41.2%	-198.8	-57.9%	-190.6	-4.1%	-383.8	101.4%	-307.3	-20.0%
Extraordinary Profit/(Loss)	0.0	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na
Associate Income	1.5	-2.0	na	1.8	na	3.2	76.8%	4.0	23.2%	1.0	-74.4%	0.0	na	0.0	na
Profit Before Tax	502.0	421.1	-16.1%	-221.6	na	234.7	na	433.2	84.6%	429.2	-0.9%	160.9	-62.5%	311.4	93.5%
Minorities and discontinued operations	0.0	0.0	na	228.6	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na
Tax	-111.4	-96.1	-13.7%	27.6	na	-48.8	na	-103.9	113.0%	-116.8	12.5%	-32.2	-72.5%	-62.3	93.5%
Net Profit	390.5	324.9	-16.8%	34.6	-89.4%	185.9	438.0%	329.3	77.1%	312.3	-5.1%	128.7	-58.8%	249.1	93.5%
EPS (Zl)	1.4	1.2	-16.8%	0.1	-89.4%	0.7	438.0%	1.2	77.1%	1.1	-5.1%	0.5	-58.8%	0.9	93.5%
DPS (Zl)	0.5	0.0	na	0.0	na	0.4	na	0.0	na	0.0	na	0.0	na	0.0	na
Average Diluted Number of Shares (m)	271.7	271.7	0.0%	271.7	0.0%	271.7	0.0%	271.7	0.0%	271.7	0.0%	271.7	0.0%	271.7	0.0%

Source: Company reports, Citi Research estimates

Figure 73. Kredyt Bank – Balance Sheet, 2007 – 2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	612	828	35.4%	1,175	42.0%	1,944	65.4%	785	-59.6%	800	2.0%	817	2.0%	833	2.0%
Interbank placements	2,454	339	-86.2%	520	53.5%	1,551	198.5%	1,188	-23.4%	1,212	2.0%	1,236	2.0%	1,261	2.0%
Financial Assets & Securities	6,442	9,859	53.0%	10,696	8.5%	11,650	8.9%	9,911	-14.9%	12,212	23.2%	12,749	4.4%	13,309	4.4%
Net client lending	16,622	26,733	60.8%	25,722	-3.8%	27,195	5.7%	29,086	7.0%	28,943	-0.5%	30,118	4.1%	31,341	4.1%
Fixed assets	396	422	6.4%	354	-16.2%	290	-17.8%	260	-10.6%	265	2.0%	270	2.0%	276	2.0%
Other assets	602	550	-8.5%	610	10.8%	744	22.1%	774	4.0%	345	-55.4%	365	5.6%	385	5.6%
Total Assets	27,128	38,731	42.8%	39,077	0.9%	43,374	11.0%	42,003	-3.2%	43,778	4.2%	45,555	4.1%	47,405	4.1%
Interbank borrowing	6,403	13,247	106.9%	12,403	-6.4%	12,379	-0.2%	8,487	-31.4%	7,553	-11.0%	6,571	-13.0%	5,454	-17.0%
Client deposits	17,089	20,275	18.6%	22,469	10.8%	25,661	14.2%	28,043	9.3%	30,049	7.2%	32,526	8.2%	35,207	8.2%
Other liabilities	1,360	2,563	88.4%	1,615	-37.0%	2,506	55.1%	2,408	-3.9%	2,687	11.6%	2,841	5.7%	2,878	1.3%
Minorities	0	0	na	0	na	0	na	0	na	0	na	0	na	0	na
Equity (ex Minorities)	2,276	2,646	16.2%	2,589	-2.2%	2,828	9.3%	3,066	8.4%	3,489	13.8%	3,617	3.7%	3,866	6.9%
Total liabilities & Equity	27,128	38,731	42.8%	39,077	0.9%	43,374	11.0%	42,003	-3.2%	43,778	4.2%	45,555	4.1%	47,405	4.1%
Interest Earning Assets	26,130	37,758	44.5%	38,113	na	42,340	11.1%	40,969	-3.2%	43,168	5.4%	44,920	4.1%	46,744	4.1%
BVPS (Zl)	8.38	9.74	16.2%	9.53	na	10.41	9.3%	11.28	8.4%	12.84	13.8%	13.32	3.7%	14.23	6.9%

Source: Company reports, Citi Research estimates

Figure 74. Kredyt Bank – Key Ratios, 2007 – 2014E (Percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	3.68%	3.32%	2.80%	2.80%	2.76%	1.93%	1.95%	2.03%
NIM on Total Ave. Assets	3.53%	3.22%	2.73%	2.74%	2.69%	1.89%	1.92%	2.00%
Net Fee & Commission Income/Total Income	21.4%	17.9%	19.0%	20.2%	19.4%	21.4%	21.4%	21.2%
Net Fee & Commission Income/Deposits	1.8%	1.4%	1.4%	1.3%	1.1%	1.1%	1.0%	0.9%
Cost/Income	67.4%	67.5%	63.8%	56.9%	61.4%	60.6%	63.2%	60.5%
Cost/Avg. Assets	3.9%	3.4%	2.6%	2.3%	2.3%	2.2%	2.1%	2.0%
Effective tax rate	22.2%	22.8%	12.4%	20.8%	24.0%	27.2%	20.0%	20.0%
Dividend Payout Ratio	36.2%	0.0%	0.0%	54.1%	0.0%	0.0%	0.0%	0.0%
Provisions/Avg Net Loans	-0.21%	0.50%	3.06%	1.78%	0.71%	0.66%	1.30%	1.00%
Equity/Assets	8.4%	6.8%	6.6%	6.5%	7.3%	8.0%	7.9%	8.2%
Loans/Deposits	97.3%	131.9%	114.5%	106.0%	103.7%	96.3%	92.6%	89.0%
Loans/Total Assets	61.3%	69.0%	65.8%	62.7%	69.2%	66.1%	66.1%	66.1%
ROE	17.9%	13.2%	1.3%	6.9%	11.2%	9.5%	3.6%	6.7%
ROA	1.58%	0.99%	0.09%	0.45%	0.77%	0.73%	0.29%	0.54%
NPLs/Total Loans	6.6%	4.9%	8.7%	9.7%	8.2%	9.1%	9.5%	9.0%
Provision Coverage of NPLs	73.0%	68.7%	60.4%	67.8%	56.0%	50.7%	43.0%	39.0%
RWA/Total Assets	78.3%	78.5%	71.6%	65.7%	71.5%	73.0%	73.0%	73.0%
CAR	9.7%	8.8%	11.8%	12.5%	12.5%	13.1%	13.0%	13.2%
Group Employees	6,724	7,050	4,896	4,834	4,963	4,520	4,342	4,255

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Sell	3
Price (29 Nov 12)	ZL315.00
Target price	ZL279.00
from ZL273.00	
Expected share price return	-11.4%
Expected dividend yield	0.0%
Expected total return	-11.4%
Market Cap	ZL13,274M
	US\$4,188M

Price Performance (RIC: BREP.WA, BB: BRE PW)



BRE Bank SA (BREP.WA)

Changing Business Model in Tough Times – Maintaining Sell

- **Sell** — Due to already achieved cost-effectiveness (cost-to-income ratio below 45% in 9M12), low cost of risk (70bp vs. cross-the cycle average of 100bp) and the relatively high sale of consumer loans, BRE has no tools to offset the impact of stock and sector-specific negative factors (including Commerzbank deleveraging, macro decelerating and the regulator intervening). Taking into account a lower rate environment we reduce our assumption of sustainable ROE to 11.5% from 12% (vs. the bank's 2015 target of ROE not lower than 12.2%) but we increase our TP to ZI 279 from ZI 273 due to a lower cost of equity assumption. We maintain our Sell rating.
- **3Q12 In Line** — BRE Bank reported a 3Q12 net profit of ZI 280m (-9% yoy, -12% qoq, +3% vs. Citi estimates and +0.3% vs. consensus as reported by PAP). Slightly lower than expected net fee income (-2% vs. consensus) was offset by strong financial and other income and total revenues came broadly in line with expectations (+0.1% vs. consensus), as did administrative costs (+0.6% vs. consensus) and provisioning (-1.0% vs. consensus).
- **Management Guidance** — In 2013 the bank's management expects pressure on NII due to cut interest rates and lower net fees due to reduced interchange fees (c60m). It is looking for costs to rise in line with inflation (c3%) plus ZI c 25-30m spend related to launching the renewed mBank internet banking platform plus the planned bank levy, but it may decide to cut costs if revenues disappoint. Cost of risk is expected to reach 100bp.
- **2013E EPS Estimate Cut 13%** — We lower our NIM assumptions (2.2% vs. 2.4% in 2013E and in 2014E) and reduce our net fee projections (by 12% and 4%, respectively). The negative impact of lower revenues (by 7% in 2013E and in 2014E) is partly offset by lower administrative costs projections (-1%) and decreased provisioning assumptions (by 9% in 2013E and 1% in 2014E) hence we reduce EPS estimates 13% in 2013E and 15% in 2014E.
- **Outlook for 4Q12E** — We expect ZI 219m (-22% qoq) net profit in 4Q12E, driven by slightly lower revenues (-1% qoq), seasonally higher administrative costs (+8% qoq) and rising provisioning (+8% qoq).
- **Outlook for 2013E** — We are looking for 28% decline in EPS due to 13bp lower NIM, 1.5% yoy lower net fee (+4% yoy excluding impact of cap on interchange fee), 3% yoy higher administrative costs (-1% yoy assuming no bank levy) and 47% yoy higher provisioning.

BRE Bank SA (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	641.6	1,135.0	1,149.8	832.1	1,070.8
Diluted EPS (ZL)	16.95	26.97	27.31	19.76	25.43
Diluted EPS (Old) (ZL)	16.95	27.79	26.67	22.64	30.07
PE (x)	18.6	11.7	11.5	15.9	12.4
P/BV (x)	1.9	1.6	1.4	1.3	1.2
DPS (ZL)	0.00	0.00	0.00	14.82	19.08
Net Div Yield (%)	0.0	0.0	0.0	4.7	6.1
ROE (%)	11.6	15.2	13.2	8.5	10.3

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	18.6	11.7	11.5	15.9	12.4
P/E reported (x)	18.6	11.7	11.5	15.9	12.4
P/BV (x)	1.9	1.6	1.4	1.3	1.2
P/Adjusted BV diluted (x)	1.9	1.6	1.4	1.3	1.2
Dividend yield (%)	0.0	0.0	0.0	4.7	6.1
Per Share Data (ZL)					
EPS adjusted	16.95	26.97	27.31	19.76	25.43
EPS reported	16.95	26.97	27.31	19.76	25.43
BVPS	164.20	191.17	222.81	242.58	253.19
Tangible BVPS	154.04	180.80	211.40	230.02	239.38
Adjusted BVPS diluted	164.20	191.17	222.81	242.58	253.19
DPS	0.00	0.00	0.00	14.82	19.08
Profit & Loss (ZLm)					
Net interest income	1,811	2,149	2,245	2,168	2,248
Fees and commissions	746	840	849	836	972
Other operating Income	568	575	570	560	576
Total operating income	3,125	3,564	3,664	3,564	3,796
Total operating expenses	-1,617	-1,723	-1,688	-1,742	-1,777
Oper. profit bef. provisions	1,507	1,841	1,976	1,823	2,019
Bad debt provisions	-635	-373	-529	-778	-675
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	873	1,467	1,447	1,045	1,344
Tax	-212	-323	-297	-209	-269
Extraord./Min. Int./Pref. Div.	-19	-9	-1	-4	-4
Attributable profit	642	1,135	1,150	832	1,071
Adjusted earnings	642	1,135	1,150	832	1,071
Growth Rates (%)					
EPS adjusted	342.1	59.1	1.3	-27.6	28.7
Oper. profit bef. prov.	15.4	22.1	7.4	-7.8	10.8
Balance Sheet (ZLm)					
Total assets	90,051	98,876	98,948	103,979	109,606
Avg interest earning assets	83,031	92,032	96,293	98,597	103,776
Customer loans	61,820	70,240	71,695	75,410	80,664
Gross NPLs	3,285	3,287	3,800	4,148	4,275
Liab. & shar. funds	90,051	98,876	98,948	103,979	109,606
Total customer deposits	47,420	54,244	57,229	63,786	70,398
Reserve for loan losses	2,450	2,388	2,499	2,691	2,722
Shareholders' equity	6,909	8,049	9,381	10,213	10,660
Profitability/Solvency Ratios (%)					
ROE adjusted	11.6	15.2	13.2	8.5	10.3
Net interest margin	2.18	2.33	2.33	2.20	2.17
Cost/income ratio	51.8	48.3	46.1	48.9	46.8
Cash cost/average assets	1.9	1.8	1.7	1.7	1.7
NPLs/customer loans	5.3	4.7	5.3	5.5	5.3
Reserve for loan losses/NPLs	74.6	72.7	65.8	64.9	63.7
Bad debt prov./avg. cust. loans	1.1	0.6	0.7	1.1	0.9
Loans/deposit ratio	130.4	129.5	125.3	118.2	114.6
Tier 1 capital ratio	10.4	9.6	10.5	11.0	11.0
Total capital ratio	15.9	15.0	15.3	14.7	13.6

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CitiRsch.DataServices.Global@citi.com



BRE Bank Financials

Changes in Estimates

Figure 75. BRE Bank – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty In million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	2,250.4	2,245.5	-0.2%	2,351.9	2,167.8	-7.8%	2,475.4	2,248.0	-9.2%
Net Fee & Commission Income	914.5	848.5	-7.2%	951.1	836.0	-12.1%	1,016.9	972.2	-4.4%
Financial Income	94.8	104.3	10.0%	20.0	70.0	250.0%	20.0	20.0	0.0%
Other Income	460.8	466.1	1.1%	490.8	490.4	-0.1%	558.4	555.8	-0.5%
Total Revenue	3,720.5	3,664.4	-1.5%	3,813.7	3,564.2	-6.5%	4,070.7	3,796.0	-6.7%
Labour Costs	-809.6	-825.8	2.0%	-826.5	-812.0	-1.7%	-837.1	-822.4	-1.7%
General Costs	-665.8	-672.4	1.0%	-720.3	-738.6	2.5%	-733.9	-752.2	2.5%
Depreciation	-202.4	-190.2	-6.0%	-216.4	-190.9	-11.8%	-229.7	-202.6	-11.8%
Operating Expenses	-1,677.8	-1,688.4	0.6%	-1,763.2	-1,741.5	-1.2%	-1,800.7	-1,777.3	-1.3%
Operating Profit	2,042.7	1,976.0	-3.3%	2,050.5	1,822.7	-11.1%	2,270.0	2,018.8	-11.1%
Provision Charge	-632.2	-528.6	-16.4%	-853.8	-777.5	-8.9%	-682.5	-675.2	-1.1%
Profit Before Tax	1,410.5	1,447.4	2.6%	1,196.7	1,045.2	-12.7%	1,587.5	1,343.5	-15.4%
Minorities	-2.2	-1.0	-53.0%	-4.0	-4.0	0.0%	-4.0	-4.0	0.0%
Tax	-285.6	-296.6	3.8%	-239.3	-209.0	-12.7%	-317.5	-268.7	-15.4%
Discontinued operations (after tax)	0.0	0.0	na	0.0	0.0	na	0.0	0.0	na
Net Profit	1,122.8	1,149.8	2.4%	953.4	832.1	-12.7%	1,266.0	1,070.8	-15.4%
EPS (Zl)	26.7	27.3	2.4%	22.6	19.8	-12.7%	30.1	25.4	-15.4%
DPS (Zl)	0.0	0.0	na	18.1	14.8	-18.2%	24.1	19.1	-20.7%
Average Diluted Number of Shares (m)	42.1	42.1	0.0%	42.1	42.1	0.0%	42.1	42.1	0.0%

Source: Citi Research

Figure 76. BRE Bank – Changes in Income Balance Sheet Estimates, 2012E-2014E (Polish Zloty In million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	1,111	1,111	0.0%	1,189	1,189	0.0%	1,272	1,272	0.0%
Interbank placements	3,608	3,608	0.0%	3,247	3,247	0.0%	2,922	2,922	0.0%
Financial Assets & Securities	16,050	17,463	8.8%	16,078	18,635	15.9%	16,017	18,598	16.1%
Net client lending	69,254	69,197	-0.1%	73,500	72,719	-1.1%	78,779	77,942	-1.1%
Fixed assets	916	916	0.0%	1,007	1,007	0.0%	1,108	1,108	0.0%
Other assets	6,526	6,653	1.9%	7,038	7,181	2.0%	7,617	7,764	1.9%
Total Assets	97,465	98,948	1.5%	102,059	103,979	1.9%	107,716	109,606	1.8%
Interbank borrowing	21,913	21,913	0.0%	17,092	17,092	0.0%	13,844	13,844	0.0%
Client deposits	54,831	57,229	4.4%	61,113	63,786	4.4%	67,448	70,398	4.4%
Other liabilities	11,423	10,400	-9.0%	13,597	12,859	-5.4%	15,660	14,671	-6.3%
Minorities	26	25	-4.4%	30	29	-3.8%	34	33	-3.4%
Equity (ex Minorities)	9,272	9,381	1.2%	10,226	10,213	-0.1%	10,729	10,660	-0.6%
Total liabilities & Equity	97,465	98,948	1.5%	102,059	103,979	1.9%	107,716	109,606	1.8%
Interest Earning Assets	94,797	96,152	1.4%	99,264	101,042	1.8%	104,767	106,510	1.7%
Risk Weighted Assets	76,023	73,221	-3.7%	79,606	76,945	-3.3%	84,018	81,109	-3.5%
BVPS (Zl)	220	223	1.2%	243	243	-0.1%	255	253	-0.6%

Source: Citi Research

Figure 77. BRE Bank – Changes in Income Key Ratios Estimates, 2012E-2014E (Percentage)

Key Ratios	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	2.35%	2.33%	2.42%	2.20%	2.43%	2.17%
NIM on Total Ave. Assets	2.29%	2.27%	2.36%	2.14%	2.36%	2.11%
Net Fee & Commission Income/Total Income	24.58%	23.16%	24.94%	23.46%	24.98%	25.61%
Net Fee & Commission Income/Deposits	1.67%	1.48%	1.56%	1.31%	1.51%	1.38%
Cost/Income	45.10%	46.08%	46.23%	48.86%	44.24%	46.82%
Cost/Avg. Assets	1.71%	1.71%	1.77%	1.72%	1.72%	1.66%
Effective tax rate	20.25%	20.49%	20.00%	20.00%	20.00%	20.00%
Dividend Payout Ratio	0.00%	0.00%	80.00%	75.00%	80.00%	75.00%
Provisions/Avg Net Loans	0.92%	0.77%	1.20%	1.10%	0.90%	0.90%
Equity/Assets	9.54%	9.51%	10.05%	9.85%	9.99%	9.76%
Loans/Deposits	126.30%	120.91%	120.27%	114.00%	116.80%	110.72%
Loans/Total Assets	71.06%	69.93%	72.02%	69.94%	73.14%	71.11%
ROE	12.96%	13.19%	9.78%	8.49%	12.08%	10.26%
ROA	1.14%	1.16%	0.96%	0.82%	1.21%	1.00%
NPLs/Total Loans	5.30%	5.30%	5.50%	5.50%	5.00%	5.30%
Provision Coverage of NPLs	68.33%	65.76%	68.34%	64.88%	71.23%	63.67%
RWA/Total Assets	78.00%	74.00%	78.00%	74.00%	78.00%	74.00%
Tier I Ratio (%)	9.94%	10.47%	10.69%	11.04%	10.73%	11.03%
CAR	14.60%	15.31%	14.25%	14.73%	13.26%	13.65%
Group Employees	6,206	6,124	6,083	6,002	6,022	5,942

Source: Citi Research

Financials

Figure 78. BRE Bank – Income Statement, 2007-2014E (Polish Zloty in million)

GROUP	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	1,028	1,392	35.5%	1,658	19.1%	1,811	9.2%	2,149	18.6%	2,245	4.5%	2,168	-3.5%	2,248	3.7%
Net Fee & Commission Income	564	552	-2.3%	595	7.8%	746	25.4%	840	12.6%	849	1.0%	836	-1.5%	972	16.3%
Financial Income	55	-35	na	-9	-73.3%	86	na	42	-50.9%	104	147.5%	70	-32.9%	20	-71.4%
Other Income	555	640	15.4%	608	-5.0%	482	-20.7%	533	10.6%	466	-12.5%	490	5.2%	556	13.3%
Total Revenue	2,202	2,549	15.7%	2,851	11.9%	3,125	9.6%	3,564	14.0%	3,664	2.8%	3,564	-2.7%	3,796	6.5%
Labour Costs	-629	-739	17.6%	-645	-12.8%	-744	15.5%	-810	8.8%	-826	1.9%	-812	-1.7%	-822	1.3%
General Costs	-475	-607	27.9%	-641	5.5%	-636	-0.7%	-661	4.0%	-672	1.7%	-739	9.8%	-752	1.8%
Depreciation	-176	-203	15.4%	-259	27.5%	-237	-8.7%	-251	6.1%	-190	-24.3%	-191	0.4%	-203	6.1%
Operating Expenses	-1,280	-1,550	21.1%	-1,545	-0.3%	-1,617	4.7%	-1,723	6.5%	-1,688	-2.0%	-1,742	3.1%	-1,777	2.1%
Operating Profit	922	999	8.3%	1,307	30.8%	1,507	15.4%	1,841	22.1%	1,976	7.4%	1,823	-7.8%	2,019	10.8%
Provision Charge	-77	-269	250.4%	-1,097	307.6%	-635	-42.1%	-373	-41.2%	-529	41.5%	-778	47.1%	-675	-13.2%
Associate Income	0	0	na	0	na	0	na	0	na	0	na	0	na	0	na
Profit Before Tax	846	730	-13.7%	209	-71.3%	873	316.7%	1,467	68.1%	1,447	-1.3%	1,045	-27.8%	1,344	28.5%
Minorities	-38	-32	-15.0%	-2	-95.0%	-19	1108%	-9	-50.9%	-1	-89.2%	-4	291.8%	-4	0.0%
Tax	-185	-108	-41.3%	-79	-27.3%	-212	168.4%	-323	52.5%	-297	-8.1%	-209	-29.5%	-269	28.5%
Discontinued operations (after tax)	87	268	209.7%	0	na	0	na	0	na	0	na	0	na	0	na
Net Profit	710	858	20.8%	129	-85.0%	642	397.6%	1,135	76.9%	1,150	1.3%	832	-27.6%	1,071	28.7%
EPS (Zl)	21.2	25.5	20.4%	3.8	-85.0%	16.9	342.1%	27.0	59.1%	27.3	1.3%	19.8	-27.6%	25.4	28.7%
DPS (Zl)	0.0	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	14.8	na	19.1	28.7%
Average Diluted Number of Shares (m)	33.5	33.6	0.3%	33.6	0.1%	37.9	12.6%	42.1	11.2%	42.1	0.0%	42.1	0.0%	42.1	0.0%

Source: Company reports, Citi Research estimates

Figure 79. BRE Bank – Balance Sheet, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	2,027	2,522	24.4%	3,796	50.5%	2,364	-37.7%	1,038	-56.1%	1,111	7.0%	1,189	7.0%	1,272	7.0%
Interbank placements	2,090	6,104	192.1%	2,531	-58.5%	2,511	-0.8%	4,009	59.7%	3,608	-10.0%	3,247	-10.0%	2,922	-10.0%
Financial Assets & Securities	12,062	15,760	30.7%	16,120	2.3%	21,555	33.7%	19,195	-10.9%	17,463	-9.0%	18,635	6.7%	18,598	-0.2%
Net client lending	33,683	52,142	54.8%	52,469	0.6%	59,370	13.2%	67,852	14.3%	69,197	2.0%	72,719	5.1%	77,942	7.2%
Fixed assets	670	814	21.5%	786	-3.4%	778	-1.1%	832	7.1%	916	10.0%	1,007	10.0%	1,108	10.0%
Other assets	5,451	5,262	-3.5%	5,323	1.1%	3,474	-34.7%	5,949	71.2%	6,653	11.8%	7,181	7.9%	7,764	8.1%
Total Assets	55,983	82,605	47.6%	81,024	-1.9%	90,051	11.1%	98,876	9.8%	98,948	0.1%	103,979	5.1%	109,606	5.4%
Interbank borrowing	12,287	28,791	134.3%	27,024	-6.1%	28,727	6.3%	27,391	-4.7%	21,913	-20.0%	17,092	-22.0%	13,844	-19.0%
Client deposits	32,402	37,750	16.5%	42,791	13.4%	47,420	10.8%	54,244	14.4%	57,229	5.5%	63,786	11.5%	70,398	10.4%
Other liabilities	7,853	12,016	53.0%	6,938	-42.3%	6,827	-1.6%	9,168	34.3%	10,400	13.4%	12,859	23.6%	14,671	14.1%
Minorities	117	154	31.5%	151	-1.7%	168	11.3%	24	-85.8%	25	4.3%	29	16.0%	33	13.8%
Equity (ex Minorities)	3,325	3,894	17.1%	4,120	5.8%	6,909	67.7%	8,049	16.5%	9,381	16.6%	10,213	8.9%	10,660	4.4%
Total liabilities & Equity	55,983	82,606	47.6%	81,024	-1.9%	90,051	11.1%	98,876	9.8%	98,948	0.1%	103,979	5.1%	109,606	5.4%
Interest Earning Assets	53,570	79,973	49.3%	78,431	-1.9%	87,631	11.7%	96,434	10.0%	96,152	-0.3%	101,042	5.1%	106,510	5.4%
BVPS (Zl)	99	116	17.0%	123	5.8%	164	34.0%	191	16.4%	223	16.6%	243	8.9%	253	4.4%

Source: Company reports, Citi Research estimates

Figure 80. BRE Bank – Key Ratios, 2007-2014E (Percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	2.19%	2.09%	2.09%	2.18%	2.33%	2.33%	2.20%	2.17%
NIM on Total Ave. Assets	2.09%	2.01%	2.03%	2.12%	2.27%	2.27%	2.14%	2.11%
Net Fee & Commission Income/Total Income	25.6%	21.6%	20.9%	23.9%	23.6%	23.2%	23.5%	25.6%
Net Fee & Commission Income/Deposits	1.7%	1.5%	1.4%	1.6%	1.5%	1.5%	1.3%	1.4%
Cost/Income	58.1%	60.8%	54.2%	51.8%	48.3%	46.1%	48.9%	46.8%
Cost/Avg. Assets	2.6%	2.2%	1.9%	1.9%	1.8%	1.7%	1.7%	1.7%
Effective tax rate	21.8%	14.9%	37.7%	24.3%	22.0%	20.5%	20.0%	20.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	75.0%	75.0%
Provisions/Avg Net Loans	0.27%	0.63%	2.10%	1.14%	0.59%	0.77%	1.10%	0.90%
Equity/Assets	6.1%	4.9%	5.3%	7.9%	8.2%	9.5%	9.9%	9.8%
Loans/Deposits	104.0%	138.1%	122.6%	125.2%	125.1%	120.9%	114.0%	110.7%
Loans/Total Assets	60.2%	63.1%	64.8%	65.9%	68.6%	69.9%	69.9%	71.1%
ROE	24.3%	23.8%	3.2%	11.6%	15.2%	13.2%	8.5%	10.3%
ROA	1.44%	1.24%	0.16%	0.75%	1.20%	1.16%	0.82%	1.00%
NPLs/Total Loans	2.3%	2.2%	4.7%	5.3%	4.7%	5.3%	5.5%	5.3%
Provision Coverage of NPLs	85.3%	73.5%	76.7%	74.6%	73.6%	65.8%	64.9%	63.7%
RWA/Total Assets	69.8%	71.3%	67.2%	62.6%	66.8%	74.0%	74.0%	74.0%
Tier I Ratio (%)	5.7%	5.6%	6.6%	10.4%	9.6%	10.5%	11.0%	11.0%
CAR	10.2%	10.0%	11.5%	15.9%	15.0%	15.3%	14.7%	13.6%
Group Employees	5,785	6,133	5,566	6,018	6,294	6,124	6,002	5,942

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Neutral	2
Price (29 Nov 12)	ZL89.10
Target price	ZL92.00
from ZL88.20	
Expected share price return	3.3%
Expected dividend yield	3.6%
Expected total return	6.9%
Market Cap	ZL11,592M
	US\$3,657M

Price Performance (RIC: BSK.WA, BB: BSK PW)



ING Bank Slaski SA (BSK.WA) Short Breath of Marathon Runner – Maintaining Neutral

■ **Neutral** — We like the bank's solid balance sheet (with high share of zloty-denominated mortgages and loans to municipalities, funded by stable retail deposits) but due to its low-margin business model and relatively high cost-to-income ratio (58%) ING BSK's earnings are sensitive to fluctuations in revenues which in 2013E will be under pressure due to a weaker macro and regulatory intervention. Taking into account lower rates, we lower our assumption of sustainable ROE to 13.0% from 13.5% previously and simultaneously we reduce our COE assumption to 10% from 10.5%. This leads us to increase our TP to ZI 92 from ZI 88.2 previously and maintain a Neutral rating.

■ **3Q12 Small Beat** — The bank reported a 3Q12 net profit of ZI 203m (-8% yoy, +21% qoq, +7% vs. Citi estimates and +3% vs. consensus as reported by PAP). The small earnings beat was driven by lower than expected administrative costs (-1% vs. consensus) and lower provisioning (-8% vs. consensus) while revenues came in broadly in line with expectations (net interest income +0.8% and net fee -0.2% vs. consensus).

■ **Management Guidance** — In 2013 management expects lower revenues due to the decelerating economy and implementation of a reduction in interchange fees. It will look for cost optimising but it doesn't plan radical costs cuts ("we will not fire people just because interchange was reduced") as the long term-strategy to build scale through client acquisition remains intact and management is more focused on rebounding in 2014 than on a macro-driven slowdown in 2013.

■ **2013 EPS Estimates Cut by 9%** — A reduction in our NIM assumption (to 2.8% from 2.9% previously) and decrease in our fee estimates (-7%) are only partly offset by an increase in our financial income forecasts (+31%) and a reduction in our provisioning assumptions (-12%), hence we reduce our 2013E EPS estimate by 9%.

■ **Outlook for 4Q12E** — We are looking for ZI 204m (-3% qoq) net profit in 4Q12 as we expect higher provisioning (+51% qoq) will be nearly offset by seasonally lower administrative costs (-4% qoq) and higher revenues (+2% qoq).

■ **Outlook for 2013E** — We expect EPS to decline to 26% yoy in 2013, driven by NIM lower by 16bp, 5% yoy lower net fees (-1% yoy excluding impact of interchange fee reduction), 5% yoy higher administrative costs (+2% yoy assuming lack of bank levy) and 28% yoy higher provisioning (we note that due to comparability, we assume ING BSK will report the bank levy in general costs despite it currently booking a contribution to BFG in fee costs).

ING Bank Slaski SA (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	753.1	880.1	840.4	620.4	877.7
Diluted EPS (ZL)	5.79	6.76	6.46	4.77	6.75
Diluted EPS (Old) (ZL)	5.79	6.76	6.19	5.26	8.47
PE (x)	15.4	13.2	13.8	18.7	13.2
P/BV (x)	2.1	1.8	1.5	1.5	1.4
DPS (ZL)	1.50	0.00	3.23	2.86	4.72
Net Div Yield (%)	1.7	0.0	3.6	3.2	5.3
ROE (%)	14.3	14.6	12.0	8.0	10.9

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	15.4	13.2	13.8	18.7	13.2
P/E reported (x)	15.4	13.2	13.8	18.7	13.2
P/BV (x)	2.1	1.8	1.5	1.5	1.4
P/Adjusted BV diluted (x)	2.1	1.8	1.5	1.5	1.4
Dividend yield (%)	1.7	0.0	3.6	3.2	5.3
Per Share Data (ZL)					
EPS adjusted	5.79	6.76	6.46	4.77	6.75
EPS reported	5.79	6.76	6.46	4.77	6.75
BVPS	43.43	49.30	58.59	60.13	64.02
Tangible BVPS	40.80	46.52	55.64	57.00	60.70
Adjusted BVPS diluted	43.43	49.30	58.59	60.13	64.02
DPS	1.50	0.00	3.23	2.86	4.72
Profit & Loss (ZLm)					
Net interest income	1,628	1,852	2,071	2,101	2,251
Fees and commissions	987	1,021	1,001	952	1,032
Other operating Income	65	40	131	92	76
Total operating income	2,679	2,913	3,202	3,145	3,359
Total operating expenses	-1,583	-1,664	-1,811	-1,895	-1,941
Oper. profit bef. provisions	1,097	1,249	1,391	1,250	1,418
Bad debt provisions	-204	-172	-402	-515	-367
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	893	1,076	989	735	1,051
Tax	-181	-237	-182	-146	-206
Extraord./Min. Int./Pref. Div.	41	41	33	31	32
Attributable profit	753	880	840	620	878
Adjusted earnings	753	880	840	620	878
Growth Rates (%)					
EPS adjusted	26.6	16.9	-4.5	-26.2	41.5
Oper. profit bef. prov.	10.7	13.9	11.4	-10.1	13.4
Balance Sheet (ZLm)					
Total assets	64,518	69,783	75,111	80,218	88,880
Avg interest earning assets	60,769	70,213	70,873	76,016	82,755
Customer loans	35,594	43,444	51,562	54,719	61,049
Gross NPLs	1,508	1,553	2,423	2,736	2,808
Liab. & shar. funds	64,518	69,783	75,111	80,218	88,880
Total customer deposits	47,400	52,932	55,416	57,666	62,420
Reserve for loan losses	1,085	1,114	1,302	1,377	1,303
Shareholders' equity	5,651	6,414	7,623	7,823	8,329
Profitability/Solvency Ratios (%)					
ROE adjusted	14.3	14.6	12.0	8.0	10.9
Net interest margin	2.68	2.64	2.92	2.76	2.72
Cost/income ratio	59.1	57.1	56.6	60.2	57.8
Cash cost/average assets	2.5	2.5	2.5	2.4	2.3
NPLs/customer loans	4.2	3.6	4.7	5.0	4.6
Reserve for loan losses/NPLs	72.0	71.7	53.7	50.3	46.4
Bad debt prov./avg. cust. loans	0.6	0.4	0.8	1.0	0.6
Loans/deposit ratio	75.1	82.1	93.0	94.9	97.8
Tier 1 capital ratio	13.1	11.5	13.2	14.1	13.4
Total capital ratio	13.1	12.3	13.2	14.1	13.4

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ING BSK Financials

Changes in Estimates

Figure 81. ING BSK – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	2,044.8	2,070.9	1.3%	2,165.3	2,100.9	-3.0%	2,401.1	2,250.9	-6.3%
Net Fee & Commission Income	1,010.4	1,000.6	-1.0%	1,027.5	952.0	-7.4%	1,115.2	1,032.0	-7.5%
Financial Income	120.2	114.7	-4.6%	64.0	76.0	18.8%	76.0	56.0	-26.3%
Other Income	22.4	16.1	-28.1%	24.0	16.0	-33.3%	24.0	20.0	-16.7%
Total Revenue	3,197.8	3,202.3	0.1%	3,280.9	3,144.9	-4.1%	3,616.4	3,358.9	-7.1%
Labour Costs	-895.4	-890.3	-0.6%	-918.4	-907.9	-1.1%	-950.7	-932.9	-1.9%
General Costs	-776.7	-781.8	0.7%	-835.3	-841.4	0.7%	-855.3	-856.9	0.2%
Depreciation	-138.7	-138.9	0.1%	-145.2	-145.4	0.2%	-151.1	-151.3	0.2%
Operating Expenses	-1,810.8	-1,810.9	0.0%	-1,898.8	-1,894.7	-0.2%	-1,957.1	-1,941.1	-0.8%
Operating Profit	1,387.0	1,391.4	0.3%	1,382.1	1,250.2	-9.5%	1,659.3	1,417.8	-14.6%
Provision Charge	-450.4	-402.4	-10.7%	-583.2	-515.3	-11.6%	-347.8	-366.5	5.4%
Share of Profits (Losses) of Companies Consolidated by Equity Accounting	40.7	33.3	-18.3%	46.9	31.5	-32.8%	48.8	32.8	-32.8%
Minorities	-0.2	-0.1	-50.0%	-0.4	-0.4	0.0%	-0.4	-0.4	0.0%
Profit Before Tax	977.3	1,022.2	4.6%	845.7	766.4	-9.4%	1,360.3	1,084.1	-20.3%
Tax	-171.7	-181.8	5.8%	-160.7	-145.6	-9.4%	-258.5	-206.0	-20.3%
Net Profit	805.4	840.4	4.3%	684.6	620.4	-9.4%	1,101.4	877.7	-20.3%
EPS (Zl)	6.2	6.5	4.3%	5.3	4.8	-9.4%	8.5	6.7	-20.3%
DPS (Zl)	2.5	3.2	30.4%	2.1	2.9	35.9%	5.1	4.7	-7.0%
Average Diluted Number of Shares (m)	130.1	130.1	0.0%	130.1	130.1	0.0%	130.1	130.1	0.0%

Source: Citi Research

Figure 82. ING BSK – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	1,613	1,613	0.0%	1,742	1,742	0.0%	1,881	1,881	0.0%
Interbank placements	1,045	1,045	0.0%	1,066	1,066	0.0%	1,087	1,087	0.0%
Financial Assets & Securities	18,143	20,599	13.5%	19,707	22,366	13.5%	21,403	24,280	13.4%
Net client lending	50,945	50,261	-1.3%	55,145	53,342	-3.3%	60,870	59,746	-1.8%
Fixed assets	610	610	0.0%	646	646	0.0%	685	685	0.0%
Other assets	1,040	984	-5.3%	1,139	1,056	-7.3%	1,274	1,201	-5.8%
Total Assets	73,395	75,111	2.3%	79,445	80,218	1.0%	87,200	88,880	1.9%
Interbank borrowing	3,225	3,225	0.0%	3,451	3,451	0.0%	4,314	4,314	0.0%
Client deposits	56,345	55,416	-1.6%	60,990	57,666	-5.4%	66,017	62,420	-5.4%
Other liabilities	6,478	8,844	36.5%	7,294	11,275	54.6%	8,331	13,815	65.8%
Minorities	3	2	-4.0%	3	3	-3.4%	3	3	-3.0%
Equity (ex Minorities)	7,345	7,623	3.8%	7,707	7,823	1.5%	8,535	8,329	-2.4%
Total liabilities & Equity	73,395	75,111	2.3%	79,445	80,218	1.0%	87,200	88,880	1.9%
Interest Earning Assets	71,746	73,517	2.5%	77,660	78,515	1.1%	85,241	86,994	2.1%
Risk Weighted Assets	46,973	48,071	2.3%	50,845	46,526	-8.5%	55,808	51,550	-7.6%
BVPS (Zl)	56	59	3.8%	59	60	1.5%	66	64	-2.4%

Source: Citi Research

Figure 83. ING BSK – Changes in Key Ratios Estimates, 2012E-2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	2.92%	2.92%	2.90%	2.76%	2.95%	2.72%
NIM on Total Ave. Assets	2.86%	2.86%	2.83%	2.71%	2.88%	2.66%
Net Fee & Commission Income/Total Income	31.6%	31.2%	31.3%	30.3%	30.8%	30.7%
Net Fee & Commission Income/Deposits	1.8%	1.8%	1.7%	1.7%	1.7%	1.7%
Cost/Income	56.6%	56.6%	57.9%	60.2%	54.1%	57.8%
Cost/Avg. Assets	2.5%	2.5%	2.5%	2.4%	2.3%	2.3%
Effective tax rate	17.6%	17.8%	19.0%	19.0%	19.0%	19.0%
Dividend Payout Ratio	40.0%	50.0%	40.0%	60.0%	60.0%	70.0%
Provisions/Avg Net Loans	0.97%	0.9%	1.1%	1.0%	0.6%	0.6%
Equity/Assets	10.0%	10.2%	9.7%	9.8%	9.8%	9.4%
Loans/Deposits	90.4%	90.7%	90.4%	92.5%	92.2%	95.7%
Loans/Total Assets	69.4%	66.9%	69.4%	66.5%	69.8%	67.2%
ROE	11.7%	12.0%	9.1%	8.0%	13.6%	10.9%
ROA	1.13%	1.16%	0.90%	0.80%	1.32%	1.04%
NPLs/Total Loans	4.8%	4.7%	5.0%	5.0%	4.0%	4.6%
Provision Coverage of NPLs	53.8%	53.7%	52.7%	50.3%	56.2%	46.4%
RWA/Total Assets	64.0%	64.0%	64.0%	58.0%	100.0%	-873.8%
CAR	13.0%	13.2%	12.7%	14.1%	13.8%	13.4%
Group Employees	8,712	8,678	8,712	8,678	8,712	8,678

Source: Citi Research

Financials

Figure 84. ING BSK – Income Statement, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	1,048	1,152	9.9%	1,442	25.2%	1,628	12.9%	1,852	13.8%	2,071	11.8%	2,101	1.4%	2,251	7.1%
Net Fee & Commission Income	899	890	-1.0%	900	1.1%	987	9.7%	1,021	3.4%	1,001	-2.0%	952	-4.9%	1,032	8.4%
Financial Income	62	19	-69.8%	147	683.0%	80	-45.6%	56	-29.4%	130	130.5%	100	-22.9%	80	-20.0%
Other Income	12	27	119.6%	-10	na	-3	-68.6%	18	na	16	-8.5%	16	-0.6%	20	25.0%
Total Revenue	2,021	2,087	3.3%	2,478	18.7%	2,679	8.1%	2,913	8.7%	3,202	9.9%	3,145	-1.8%	3,359	6.8%
Labour Costs	-700	-783	11.7%	-717	-8.4%	-822	14.6%	-844	2.7%	-890	5.5%	-908	2.0%	-933	2.8%
General Costs	-525	-591	12.4%	-647	9.5%	-640	-1.0%	-688	7.5%	-782	13.6%	-841	7.6%	-857	1.8%
Depreciation	-155	-134	-13.6%	-124	-7.4%	-121	-2.4%	-133	9.6%	-139	4.7%	-145	4.7%	-151	4.1%
Operating Expenses	-1,381	-1,507	9.1%	-1,488	-1.3%	-1,583	6.4%	-1,664	5.1%	-1,811	8.8%	-1,895	4.6%	-1,941	2.5%
Operating Profit	640	580	-9.3%	991	70.7%	1,097	10.7%	1,249	13.9%	1,391	11.4%	1,250	-10.1%	1,418	13.4%
Provision Charge	103	-66	na	-304	364.1%	-204	-33.1%	-172	-15.3%	-402	133.4%	-515	28.1%	-367	-28.9%
Extraordinary Profit/(Loss)	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na
Associate Income	44	48	10.6%	52	8.0%	41	-20.8%	41	-0.1%	33	-19.2%	31	-5.4%	33	4.1%
Minorities	-6	0	-99.9%	0	180.0%	0	178.6%	0	na	0	na	0	300.0%	0	0.0%
Profit Before Tax	787	563	-28.5%	738	31.1%	934	26.5%	1,118	19.6%	1,022	-8.5%	766	-25.0%	1,084	41.5%
Tax	-150	-118	-21.7%	-143	21.8%	-181	26.3%	-237	31.2%	-182	-23.5%	-146	-19.9%	-206	41.5%
Net Profit	631	445	-29.4%	595	33.6%	753	26.6%	880	16.9%	840	-4.5%	620	-26.2%	878	41.5%
EPS (Zl)	4.8	3.4	-29.4%	4.6	33.6%	5.8	26.6%	6.8	16.9%	6.5	-4.5%	4.8	-26.2%	6.7	41.5%
DPS (Zl)	1.2	0.0	na	0.0	na	1.5	na	0.0	na	3.2	na	2.9	-11.4%	4.7	65.1%
Average Diluted Number of Shares (m)	130.1	130.1	0.0%	130.1	0.0%	130.1	0.0%	130.1	0.0%	130.1	0.0%	130.1	0.0%	130.1	0.0%

Source: Company reports, Citi Research estimates

Figure 85. ING BSK – Balance Sheet, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	1,842	1,370	-25.6%	2,657	93.9%	2,394	-9.9%	1,493	-37.6%	1,613	8.0%	1,742	8.0%	1,881	8.0%
Interbank placements	15,184	7,787	-48.7%	1,184	-84.8%	1,181	-0.3%	1,025	-13.2%	1,045	2.0%	1,066	2.0%	1,087	2.0%
Financial Assets & Securities	17,300	33,377	92.9%	24,091	-27.8%	24,930	3.5%	23,382	-6.2%	20,599	-11.9%	22,366	8.6%	24,280	8.6%
Net client lending	16,379	25,743	57.2%	30,593	18.8%	34,509	12.8%	42,330	22.7%	50,261	18.7%	53,342	6.1%	59,746	12.0%
Fixed assets	533	544	2.1%	549	0.9%	544	-0.8%	575	5.7%	610	6.0%	646	6.0%	685	6.0%
Other assets	773	790	2.2%	810	2.5%	959	18.4%	978	2.0%	984	0.6%	1,056	7.3%	1,201	13.7%
Total Assets	52,011	69,610	33.8%	59,883	-14.0%	64,518	7.7%	69,783	8.2%	75,111	7.6%	80,218	6.8%	88,880	10.8%
Interbank borrowing	1,810	11,993	562.5%	3,974	-66.9%	4,039	1.6%	4,962	22.8%	3,225	-35.0%	3,451	7.0%	4,314	25.0%
Client deposits	44,502	47,067	5.8%	47,585	1.1%	47,400	-0.4%	52,932	11.7%	55,416	4.7%	57,666	4.1%	62,420	8.2%
Other liabilities	1,858	6,326	240.4%	3,438	-45.6%	7,425	116.0%	5,473	-26.3%	8,844	61.6%	11,275	27.5%	13,815	22.5%
Minorities	2	2	33.7%	2	0.6%	2	1.7%	2	-2.4%	2	4.6%	3	16.7%	3	14.3%
Equity (ex Minorities)	3,839	4,222	10.0%	4,884	15.7%	5,651	15.7%	6,414	13.5%	7,623	18.9%	7,823	2.6%	8,329	6.5%
Total liabilities & Equity	52,011	69,610	33.8%	59,883	-14.0%	64,518	7.7%	69,783	8.2%	75,111	7.6%	80,218	6.8%	88,880	10.8%
Interest Earning Assets	50,705	68,276	34.7%	58,525	-14.3%	63,014	7.7%	68,230	8.3%	73,517	7.7%	78,515	6.8%	86,994	10.8%
BVPS (Zl)	30	32	10.0%	38	15.7%	43	15.7%	49	13.5%	59	18.9%	60	2.6%	64	6.5%

Source: Company reports, Citi Research estimates

Figure 86. ING BSK – Key Ratios, 2007-2014E (percentage)

	2007	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	2.14%	1.94%	2.27%	2.68%	2.64%	2.92%	2.76%	2.72%
NIM on Total Ave. Assets	2.09%	1.89%	2.23%	2.62%	2.76%	2.86%	2.71%	2.66%
Net Fee & Commission Income/Total Income	44.5%	42.6%	36.3%	36.8%	35.1%	31.2%	30.3%	30.7%
Net Fee & Commission Income/Deposits	2.0%	1.9%	1.9%	2.1%	1.9%	1.8%	1.7%	1.7%
Cost/Income	68.3%	72.2%	60.0%	59.1%	57.1%	56.6%	60.2%	57.8%
Cost/Avg. Assets	2.7%	2.5%	2.3%	2.5%	2.5%	2.5%	2.4%	2.3%
Effective tax rate	19.1%	20.9%	19.4%	19.4%	21.2%	17.8%	19.0%	19.0%
Dividend Payout Ratio	24.1%	0.0%	0.0%	25.9%	0.0%	50.0%	60.0%	70.0%
Provisions/Avg Net Loans	-0.71%	0.31%	1.08%	0.63%	0.45%	0.87%	0.99%	0.65%
Equity/Assets	7.4%	6.1%	8.2%	8.8%	9.2%	10.2%	9.8%	9.4%
Loans/Deposits	36.8%	54.7%	64.3%	72.8%	80.0%	90.7%	92.5%	95.7%
Loans/Total Assets	31.5%	37.0%	51.1%	53.5%	60.7%	66.9%	66.5%	67.2%
ROE	16.6%	11.1%	13.1%	14.3%	14.6%	12.0%	8.0%	10.9%
ROA	1.26%	0.73%	0.92%	1.21%	1.31%	1.16%	0.80%	1.04%
NPLs/Total Loans	3.0%	1.9%	3.7%	4.2%	3.6%	4.7%	5.0%	4.6%
Provision Coverage of NPLs	110.8%	100.0%	75.7%	72.0%	71.7%	53.7%	50.3%	46.4%
RWA/Total Assets	43.7%	52.7%	58.2%	57.1%	64.0%	64.0%	58.0%	58.0%
CAR	13.1%	10.4%	12.0%	13.1%	12.3%	13.2%	14.1%	13.4%
Group Employees	8,074	8,577	8,291	8,472	8,409	8,678	8,678	8,678

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Sell	3
Price (29 Nov 12)	ZL4.27
Target price	ZL3.70
from ZL3.85	
Expected share price return	-13.3%
Expected dividend yield	0.0%
Expected total return	-13.3%
Market Cap	ZL5,180M
	US\$1,634M

Price Performance (RIC: MILP.WA, BB: MIL PW)



Bank Millennium SA (MILP.WA) New Strategy, Old Challenges – Maintaining Sell

- **Sell** — Given Millennium's strong retail franchise we like the bank's plans to focus on consumer loans and mobile banking but we view the 14-15% ROE target as difficult to achieve (we note that management's previous ROE targets were not met). Taking into account low interest rates, we lower our assumption of sustainable ROE to 10% from 11% previously and reduce our cost of equity assumption to 11% from 11.5%. This leads us to lower our TP to ZI 3.7 from ZI 3.85. We maintain our Sell rating.
- **3Q12 Beat** — Bank Millennium reported a 3Q12 net profit of ZI 125m (+0.1% yoy, +12.7% qoq, +4% vs. Citi estimates and +9% vs. consensus as reported by PAP). The earnings beat was driven by solid financial and other income (ZI 65m vs. consensus at ZI 50m), positively affected by gains on fixed-income securities. Core revenues were slightly worse than expected (net interest income -3% and net fee -2% vs. consensus) while administrative costs and provisions were slightly better than projected (-1% and -1%, respectively).
- **2013E EPS Increased by 10%** — Due to lower NIM estimates (to 2.1% from 2.2% in 2013E and to 2.1% from 2.5% in 2014E, decreased due to lower projections of interest rates), we reduce our revenue estimates by 2% and by 10%, respectively. However, we lower our cost of risk assumptions (80bp vs. 100bp in 2013E and 62bp vs. 70bp in 2014E). In sum, these changes lead us to increase 2013E EPS by 10% in 2013E and decrease 2014E EPS by 28%.
- **Outlook for 4Q12E** — We are looking for ZI 104m (-17% qoq) net profit, driven by 1% qoq higher revenues, 3% qoq seasonally higher administrative costs and 38% qoq increased provisioning.
- **Outlook for 2013E** — We expect EPS to decline 20% qoq due to 18bp lower NIM, 1% yoy lower net fees (+4% yoy excluding impact of interchange fee), +5% yoy higher administrative costs (+1% yoy assuming lack of bank levy) and 35% higher provisioning.

Bank Millennium SA (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	326.0	466.5	449.5	348.7	434.2
Diluted EPS (ZL)	0.30	0.38	0.37	0.29	0.36
Diluted EPS (Old) (ZL)	0.30	0.38	0.35	0.26	0.49
PE (x)	14.3	11.1	11.5	14.9	11.9
P/BV (x)	1.3	1.1	1.1	1.0	0.9
DPS (ZL)	0.10	0.00	0.00	0.14	0.18
Net Div Yield (%)	2.3	0.0	0.0	3.4	4.2
ROE (%)	9.5	10.8	9.5	6.9	8.0

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	14.3	11.1	11.5	14.9	11.9
P/E reported (x)	14.3	11.1	11.5	14.9	11.9
P/BV (x)	1.3	1.1	1.1	1.0	0.9
P/Adjusted BV diluted (x)	1.3	1.1	1.1	1.0	0.9
Dividend yield (%)	2.3	0.0	0.0	3.4	4.2
Per Share Data (ZL)					
EPS adjusted	0.30	0.38	0.37	0.29	0.36
EPS reported	0.30	0.38	0.37	0.29	0.36
BVPS	3.37	3.78	4.03	4.31	4.67
Tangible BVPS	3.35	3.75	4.00	4.29	4.64
Adjusted BVPS diluted	3.37	3.78	4.03	4.31	4.67
DPS	0.10	0.00	0.00	0.14	0.18
Profit & Loss (ZLm)					
Net interest income	927	1,142	1,166	1,111	1,159
Fees and commissions	565	562	551	548	568
Other operating Income	224	186	212	277	291
Total operating income	1,716	1,889	1,930	1,936	2,018
Total operating expenses	-1,063	-1,105	-1,099	-1,150	-1,185
Oper. profit bef. provisions	654	784	830	786	833
Bad debt provisions	-227	-174	-252	-333	-273
Non-operating/exceptionals	-19	-19	-19	-19	-19
Pre-tax profit	408	591	559	435	542
Tax	-82	-125	-113	-87	-109
Extraord./Min. Int./Pref. Div.	0	0	4	1	1
Attributable profit	326	466	449	349	434
Adjusted earnings	326	466	449	349	434
Growth Rates (%)					
EPS adjusted	nm	28.5	-3.6	-22.4	24.5
Oper. profit bef. prov.	44.0	19.9	5.9	-5.3	6.0
Balance Sheet (ZLm)					
Total assets	46,984	50,838	52,574	54,708	58,273
Avg interest earning assets	45,251	48,178	50,915	52,876	55,685
Customer loans	37,926	42,550	41,844	43,731	46,939
Gross NPLs	2,195	2,104	2,260	2,449	2,441
Liab. & shar. funds	46,984	50,838	52,574	54,708	58,273
Total customer deposits	35,395	37,428	42,119	45,591	49,349
Reserve for loan losses	1,187	1,217	1,093	1,326	1,489
Shareholders' equity	4,091	4,586	4,884	5,233	5,667
Profitability/Solvency Ratios (%)					
ROE adjusted	9.5	10.8	9.5	6.9	8.0
Net interest margin	2.05	2.37	2.29	2.10	2.08
Cost/income ratio	61.9	58.5	57.0	59.4	58.7
Cash cost/average assets	2.3	2.3	2.1	2.1	2.1
NPLs/customer loans	5.8	4.9	5.4	5.6	5.2
Reserve for loan losses/NPLs	54.1	57.9	48.4	54.1	61.0
Bad debt prov./avg. cust. loans	0.6	0.4	0.6	0.8	0.6
Loans/deposit ratio	107.1	113.7	99.3	95.9	95.1
Tier 1 capital ratio	12.3	11.4	11.9	12.3	12.5
Total capital ratio	14.4	13.2	12.5	12.8	13.0

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please contact Citi Research Data Services at
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Bank Millennium Financials

Changes in Estimates

Figure 87. Millennium – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	1,196.1	1,165.8	-2.5%	1,211.8	1,111.3	-8.3%	1,429.2	1,159.1	-18.9%
Net Fee & Commission Income	560.7	551.3	-1.7%	549.8	548.0	-0.3%	593.7	567.5	-4.4%
Financial Income	38.5	56.1	45.7%	75.1	107.5	43.1%	76.9	109.1	41.9%
Other Income	152.7	156.3	2.4%	173.1	169.4	-2.1%	186.2	182.2	-2.1%
Total Revenue	1,948.0	1,929.6	-0.9%	2,009.8	1,936.2	-3.7%	2,286.0	2,017.9	-11.7%
Labour Costs	-555.8	-561.2	1.0%	-556.2	-567.1	2.0%	-580.2	-591.6	2.0%
General Costs	-511.5	-502.0	-1.9%	-557.2	-546.6	-1.9%	-566.7	-555.8	-1.9%
Depreciation	-56.4	-55.3	-2.0%	-57.4	-55.2	-3.9%	-58.6	-56.3	-3.9%
Operating Expenses	-1,123.7	-1,118.5	-0.5%	-1,170.9	-1,168.9	-0.2%	-1,205.5	-1,203.7	-0.2%
Operating Profit	824.3	811.0	-1.6%	838.9	767.2	-8.5%	1,080.5	814.2	-24.6%
Provision Charge	-301.2	-252.2	-16.3%	-442.9	-332.6	-24.9%	-332.3	-272.7	-17.9%
Share of Profits (Losses) of Companies Consolidated by Equity Accounting	4.2	4.1	-2.2%	1.4	1.3	-12.7%	1.4	1.3	-12.7%
Minorities	0.0	0.0	na	0.0	0.0	na	0.0	0.0	na
Profit Before Tax	527.2	562.9	6.8%	397.5	435.9	9.7%	749.6	542.8	-27.6%
Tax	-107.8	-113.5	5.2%	-79.5	-87.2	9.7%	-149.9	-108.6	-27.6%
Net Profit	419.4	449.5	7.2%	318.0	348.7	9.7%	599.7	434.2	-27.6%
EPS (Zl)	0.35	0.37	7.2%	0.26	0.29	9.7%	0.49	0.36	-27.6%
DPS (Zl)	0.12	0.00	na	0.13	0.14	9.7%	0.25	0.18	-27.6%
Average Diluted Number of Shares (m)	1,213.1	1,213.1	0.0%	1,213.1	1,213.1	0.0%	1,213.1	1,213.1	0.0%

Source: Citi Research

Figure 88. Millennium – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	2,058	2,058	0.0%	2,100	2,100	0.0%	2,142	2,142	0.0%
Interbank placements	2,716	2,716	0.0%	2,771	2,771	0.0%	2,827	2,827	0.0%
Financial Assets & Securities	4,896	6,299	28.6%	5,192	6,652	28.1%	5,503	7,022	27.6%
Net client lending	42,923	40,750	-5.1%	46,006	42,405	-7.8%	49,310	45,451	-7.8%
Fixed assets	214	214	0.0%	217	217	0.0%	219	219	0.0%
Other assets	584	535	-8.3%	634	564	-11.1%	689	612	-11.1%
Total Assets	53,392	52,574	-1.5%	56,920	54,708	-3.9%	60,689	58,273	-4.0%
Interbank borrowing	2,579	2,579	0.0%	2,501	2,501	0.0%	2,251	2,251	0.0%
Client deposits	41,499	42,119	1.5%	44,920	45,591	1.5%	48,623	49,349	1.5%
Other liabilities	4,460	2,992	-32.9%	4,474	1,383	-69.1%	4,190	1,005	-76.0%
Minorities	0	0	na	0	0	na	0	0	na
Equity (ex Minorities)	4,854	4,884	0.6%	5,025	5,233	4.1%	5,625	5,667	0.7%
Total liabilities & Equity	53,392	52,574	-1.5%	56,920	54,708	-3.9%	60,689	58,273	-4.0%
Risk Weighted Assets	40,044	40,482	1.1%	42,690	42,125	-1.3%	45,517	44,870	-1.4%
BVPS (Zl)	4.00	4.03	0.6%	4.14	4.31	4.1%	4.64	4.67	0.7%

Source: Citi Research

Figure 89. Millennium – Changes in Key Ratios Estimates, 2012E-2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	2.33%	2.29%	2.23%	2.10%	2.47%	2.08%
NIM on AIEA including swaps	2.40%	2.41%	2.28%	2.21%	2.52%	2.19%
NIM on Total Ave. Assets	2.30%	2.25%	2.20%	2.07%	2.43%	2.05%
Net Fee & Commission Income/Total Income	28.8%	28.6%	27.4%	28.3%	26.0%	28.1%
Net Fee & Commission Income/Deposits	1.4%	1.3%	1.2%	1.2%	1.2%	1.2%
Cost/Income	57.7%	58.0%	58.3%	60.4%	52.7%	59.6%
Cost/Avg. Assets	2.2%	2.2%	2.1%	2.2%	2.1%	2.1%
Effective tax rate	20.5%	20.2%	20.0%	20.0%	20.0%	20.0%
Dividend Payout Ratio	35.0%	0.0%	50.0%	50.0%	50.0%	50.0%
Provisions/Avg Net Loans	0.7%	0.6%	1.00%	0.80%	0.70%	0.62%
Equity/Assets	9.1%	9.3%	8.8%	9.6%	9.3%	9.7%
Loans/Deposits	103.4%	96.8%	102.4%	93.0%	101.4%	92.1%
Loans/Total Assets	80.4%	77.5%	80.8%	77.5%	81.3%	78.0%
ROE	8.9%	9.5%	6.4%	6.9%	11.3%	8.0%
ROA	0.80%	0.87%	0.58%	0.65%	1.02%	0.77%
NPLs/Total Loans	5.4%	5.4%	5.6%	5.6%	5.2%	5.2%
Provision Coverage of NPLs	48.0%	48.4%	55.8%	54.1%	64.4%	61.0%
RWA/Total Assets	75.0%	77.0%	75.0%	77.0%	75.0%	77.0%
CAR	11.5%	12.5%	11.2%	12.8%	11.7%	13.0%
Group Employees	6,036	5,998	5,976	5,938	5,976	5,938

Source: Citi Research

Financials

Figure 90. Millennium – Income Statement, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Net Interest Income	771.7	980.9	27.1%	598.5	-39.0%	927.5	55.0%	1,141.8	23.1%	1,165.8	2.1%	1,111.3	-4.7%	1,159.1	4.3%
Net Fee & Commission Income	543.2	472.0	-13.1%	493.8	4.6%	564.9	14.4%	561.8	-0.6%	551.3	-1.9%	548.0	-0.6%	567.5	3.6%
Financial Income	91.2	149.8	64.3%	274.5	83.2%	92.8	-66.2%	82.5	-11.0%	56.1	-32.0%	107.5	91.4%	109.1	1.5%
Other Income	303.3	245.9	-18.9%	87.1	-64.6%	131.1	50.6%	103.0	-21.4%	156.3	51.7%	169.4	8.4%	182.2	7.6%
Total Revenue	1,709.4	1,848.6	8.1%	1,453.9	-21.4%	1,716.3	18.0%	1,889.1	10.1%	1,929.6	2.1%	1,936.2	0.3%	2,017.9	4.2%
Labour Costs	-538.8	-609.0	13.0%	-470.7	-22.7%	-525.9	11.7%	-540.2	2.7%	-561.2	3.9%	-567.1	1.1%	-591.6	4.3%
General Costs	-431.1	-510.2	18.3%	-472.0	-7.5%	-481.1	1.9%	-519.1	7.9%	-502.0	-3.3%	-546.6	8.9%	-555.8	1.7%
Depreciation	-87.1	-70.4	-19.2%	-79.6	13.1%	-74.6	-6.3%	-64.8	-13.1%	-55.3	-14.7%	-55.2	-0.2%	-56.3	2.0%
Operating Expenses	-1,057	-1,190	12.5%	-1,022	-14.1%	-1,082	5.8%	-1,124	3.9%	-1,118	-0.5%	-1,169	4.5%	-1,204	3.0%
Operating Profit	652.3	659.0	1.0%	431.5	-34.5%	634.7	47.1%	765.1	20.5%	811.0	6.0%	767.2	-5.4%	814.2	6.1%
Provision Charge	-67.8	-137.3	102.5%	-436.7	218.1%	-226.9	-48.0%	-173.8	-23.4%	-252.2	45.1%	-332.6	31.9%	-272.7	-18.0%
Extraordinary Profit/(Loss)	0.0	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na
Associate Income	0.0	0.0	na	7.0	na	0.0	na	-0.2	na	4.1	nm	1.3	-69.4%	1.3	0.0%
Profit Before Tax	584.6	521.7	-10.7%	1.9	-99.6%	407.8	nm	591.1	44.9%	562.9	-4.8%	435.9	-22.6%	542.8	24.5%
Minorities	0.0	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na	0.0	na
Tax	-123.0	-108.3	-11.9%	-0.4	-99.6%	-81.8	nm	-124.6	52.3%	-113.5	-8.9%	-87.2	-23.2%	-108.6	24.5%
Net Profit	461.6	413.4	-10.4%	1.5	-99.6%	326.0	nm	466.5	43.1%	449.5	-3.6%	348.7	-22.4%	434.2	24.5%
EPS (Zl)	0.5	0.43	-10.4%	0.00	-99.6%	0.30	nm	0.38	28.5%	0.37	-3.6%	0.29	-22.4%	0.36	24.5%
DPS (Zl)	0.2	0.00	na	0.00	na	0.10	na	0.00	na	0.00	na	0.14	na	0.18	24.5%
Average Diluted Number of Shares (m)	965.7	965.7	0.0%	965.7	0.0%	1,089.4	12.8%	1,213.1	11.4%	1,213.1	0.0%	1,213.1	0.0%	1,213.1	0.0%

Source: Company reports, Citi Research estimates

Figure 91. Millennium – Balance Sheet, 2007-2014E (Polish Zloty in million)

	2007	2008	chg	2009	chg	2010	chg	2011	chg	2012E	chg	2013E	chg	2014E	chg
Cash and NBP Balances	1,257	1,803	43.4%	2,191	21.6%	2,051	-6.4%	2,018	-1.6%	2,058	2.0%	2,100	2.0%	2,142	2.0%
Interbank placements	1,082	1,641	51.7%	904	-44.9%	1,541	70.4%	2,663	72.8%	2,716	2.0%	2,771	2.0%	2,827	2.0%
Financial Assets & Securities	5,247	9,204	75.4%	7,573	-17.7%	6,018	-20.5%	3,994	-33.6%	6,299	57.7%	6,652	5.6%	7,022	5.6%
Net client lending	22,027	33,748	53.2%	33,485	-0.8%	36,738	9.7%	41,332	12.5%	40,750	-1.4%	42,405	4.1%	45,451	7.2%
Fixed assets	337	385	14.1%	347	-10.0%	242	-30.2%	212	-12.3%	214	1.0%	217	1.0%	219	1.0%
Other assets	579	334	-42.3%	413	23.5%	394	-4.6%	619	57.2%	535	-13.5%	564	5.3%	612	8.6%
Total Assets	30,530	47,115	54.3%	44,913	-4.7%	46,984	4.6%	50,838	8.2%	52,574	3.4%	54,708	4.1%	58,273	6.5%
Interbank borrowing	3,295	4,563	38.5%	7,252	58.9%	2,755	-62.0%	3,438	24.8%	2,579	-25.0%	2,501	-3.0%	2,251	-10.0%
Client deposits	21,801	31,702	45.4%	31,559	-0.5%	35,395	12.2%	37,428	5.7%	42,119	12.5%	45,591	8.2%	49,349	8.2%
Other liabilities	2,915	8,035	175.7%	3,316	-58.7%	4,743	43.0%	5,386	13.5%	2,992	-44.5%	1,383	-53.8%	1,005	-27.3%
Minorities	0	0	na	0	na	0	na	0	na	0	na	0	na	0	na
Equity (ex Minorities)	2,520	2,815	11.7%	2,787	-1.0%	4,091	46.8%	4,586	12.1%	4,884	6.5%	5,233	7.1%	5,667	8.3%
Total liabilities & Equity	30,530	47,115	54.3%	44,914	-4.7%	46,984	4.6%	50,838	8.2%	52,574	3.4%	54,708	4.1%	58,273	6.5%
Interest Earning Assets	29,614	46,396	56.7%	44,154	-4.8%	46,349	5.0%	50,007	7.9%	51,824	3.6%	53,928	4.1%	57,441	6.5%
BVPS (Zl)	2.61	2.91	11.7%	2.89	-1.0%	3.37	16.8%	3.78	12.1%	4.03	6.5%	4.31	7.1%	4.67	8.3%

Source: Company reports, Citi Research estimates

Figure 92. Millennium – Key Ratios, 2007-2014E (Percentage)

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
NIM on AIEA	2.89%	2.58%	1.32%	2.05%	2.37%	2.29%	2.10%	2.08%
NIM on Total Ave. Assets	2.79%	2.53%	1.30%	2.02%	2.33%	2.25%	2.07%	2.05%
Net Fee & Commission Income/Total Income	31.8%	25.5%	34.0%	32.9%	29.7%	28.6%	28.3%	28.1%
Net Fee & Commission Income/Deposits	2.5%	1.5%	1.6%	1.6%	1.5%	1.3%	1.2%	1.2%
Cost/Income	61.8%	64.4%	70.3%	63.0%	59.5%	58.0%	60.4%	59.6%
Cost/Avg. Assets	3.8%	3.1%	2.2%	2.4%	2.3%	2.2%	2.2%	2.1%
Effective tax rate	21.0%	20.8%	20.3%	20.1%	21.1%	20.2%	20.0%	20.0%
Dividend Payout Ratio	35.0%	0.0%	0.0%	37.2%	0.0%	0.0%	50.0%	50.0%
Provisions/Avg Net Loans	0.37%	0.49%	1.30%	0.65%	0.45%	0.61%	0.80%	0.62%
Equity/Assets	8.3%	6.0%	6.2%	8.7%	9.0%	9.3%	9.6%	9.7%
Loans/Deposits	101.0%	106.5%	106.1%	103.8%	110.4%	96.8%	93.0%	92.1%
Loans/Total Assets	72.1%	71.6%	74.6%	78.2%	81.3%	77.5%	77.5%	78.0%
ROE	19.5%	15.5%	0.1%	9.5%	10.8%	9.5%	6.9%	8.0%
ROA	1.67%	1.06%	0.00%	0.71%	0.95%	0.87%	0.65%	0.77%
NPLs/Total Loans	3.4%	3.4%	5.9%	5.8%	4.9%	5.4%	5.6%	5.2%
Provision Coverage of NPLs	79.5%	64.4%	54.4%	54.1%	57.9%	48.4%	54.1%	61.0%
RWA/Total Assets	68.4%	73.5%	68.8%	67.6%	70.9%	77.0%	77.0%	77.0%
CAR	13.7%	10.2%	11.3%	14.4%	13.2%	12.5%	12.8%	13.0%
Group Employees	6,067	7,049	6,245	6,135	6,289	5,998	5,938	5,938

Source: Company reports, Citi Research estimates

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

Neutral/High Risk	2H
from Neutral	
Price (29 Nov 12)	ZL1.62
Target price	ZL1.81
from ZL1.82	
Expected share price return	11.7%
Expected dividend yield	0.0%
Expected total return	11.7%
Market Cap	ZL3,872M
	US\$1,222M

Price Performance (RIC: GNB.WA, BB: GNB PW)



Getin Noble Bank (GNB.WA)

Insurance Risks – Changing to Neutral/High Risk from Neutral

■ **Neutral/High Risk** — Due to a high share of fees from sale of insurance products in total fees (38% in 9M12) and the importance of these revenues for the bank's profitability (in 9M12 they constituted 88% of pre-tax profit), the flagged recommendation on good practice in selling insurance products through banks will be a crucial factor impacting 2013E results. We maintain our assumption of sustainable ROE at 11% and taking into account lower cost of equity (11.0% vs. 11.5% previously) and lower EPS estimates, we trim our TP to ZL 1.81 from ZL 1.82. Given regulatory risk related to sale of insurance products and an ETR in a range between 0 and 25% we change rating to Neutral/High Risk from Neutral.

■ **3Q12 Miss** — Getin Noble Bank reported a 3Q12 net profit of ZL 61m (-32% yoy and -25% qoq, -2% vs. Citi estimates and -5% vs. consensus as reported by PAP). Net interest income improved qoq and came in 3% above consensus but net fees (-4% vs. consensus) and other income (ZL -3m vs. consensus at ZL 13m) were worse than expected. Hence weak non-interest income coupled with higher than anticipated provisioning (+4% vs. consensus) led to the earnings miss.

■ **Management Guidance** — In December the bank plans to launch new generation internet bank (Get Up) targeting less affluent clients. Longer term the plan is to have cost of risk equal to half of net interest margin and that goal is planned to be achieved by increasing NIM (due partly to a lower cost of funding owing to retail deposits collected by Get Up) and lowering cost of risk due to solving problem of pre-Lehman FX mortgages and maintaining the current high quality of new lending.

■ **2013E EPS Estimates Cut by 25%** — We lower our NIM assumptions (to 2.5% from 2.7% in 2013E and 2.7% from 3.0% in 2014E) and reduce our fee forecasts (-11% and -5%, respectively). Lowered revenues (-9% and -7%, respectively) are partly offset by decreased administrative costs projections (-8% in 2013E and 2014E) and provisioning estimates (-8% in 2014E, no change in 2013E) and we cut our EPS estimates by 25% in 2013E and by 7% in 2014E.

■ **4Q12E Outlook** — We are looking for ZL 67m (+10% qoq) net profit driven by flat revenues, 2% qoq higher administrative costs and 10% qoq lower provisioning.

■ **2013E Outlook** — We think that an improvement in banking business (9bp higher NIM, flat provisioning) will offset the lack of gains on disinvestments (ZL 84m in 1Q12) and we expect broadly flat EPS in 2013E (+1% yoy). We forecast flat fees (with immaterial impact from lower interchange fees) and 3% yoy higher administrative costs (-2% yoy excluding impact of the potential bank levy).

Getin Noble Bank (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Net Income (ZLM)	450.1	950.1	367.8	371.4	579.3
Diluted EPS (ZL)	0.18	0.37	0.14	0.14	0.22
Diluted EPS (Old) (ZL)	0.18	0.37	0.15	0.19	0.24
PE (x)	8.8	4.4	11.7	11.6	7.4
P/BV (x)	0.5	0.4	1.0	0.9	0.8
DPS (ZL)	0.00	0.00	0.00	0.00	0.15
Net Div Yield (%)	0.0	0.0	0.0	0.0	9.4
ROE (%)	14.6	25.3	8.5	8.1	11.4

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	8.8	4.4	11.7	11.6	7.4
P/E reported (x)	8.8	4.4	11.7	11.6	7.4
P/BV (x)	0.5	0.4	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.2	1.0	1.0	0.9	0.8
Dividend yield (%)	0.0	0.0	0.0	0.0	9.4
Per Share Data (ZL)					
EPS adjusted	0.18	0.37	0.14	0.14	0.22
EPS reported	0.18	0.37	0.14	0.14	0.22
BVPS	3.45	4.43	1.67	1.81	2.03
Tangible BVPS	3.22	4.29	1.62	1.76	1.97
Adjusted BVPS diluted	1.34	1.59	1.67	1.81	2.03
DPS	0.00	0.00	0.00	0.00	0.15
Profit & Loss (ZLm)					
Net interest income	1,052	1,344	1,333	1,456	1,627
Fees and commissions	962	869	803	801	894
Other operating Income	145	202	58	74	71
Total operating income	2,159	2,415	2,194	2,331	2,592
Total operating expenses	-733	-833	-833	-859	-887
Oper. profit bef. provisions	1,426	1,582	1,361	1,473	1,705
Bad debt provisions	-1,057	-1,208	-1,003	-1,009	-981
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	369	374	359	464	724
Tax	12	-66	-60	-93	-145
Extraord./Min. Int./Pref. Div.	69	643	69	0	0
Attributable profit	450	950	368	371	579
Adjusted earnings	450	950	368	371	579
Growth Rates (%)					
EPS adjusted	36.9	102.9	-62.7	1.0	56.0
Oper. profit bef. prov.	28.9	10.9	-14.0	8.2	15.7
Balance Sheet (ZLm)					
Total assets	42,798	54,488	57,988	60,857	63,328
Avg interest earning assets	37,023	47,231	54,448	57,476	60,059
Customer loans	36,033	44,733	46,838	50,244	52,472
Gross NPLs	3,676	5,495	6,323	7,034	7,084
Liab. & shar. funds	42,798	54,488	57,988	60,857	63,328
Total customer deposits	37,026	47,059	49,688	51,189	52,218
Reserve for loan losses	2,579	3,678	4,142	4,771	5,151
Shareholders' equity	3,294	4,225	4,423	4,795	5,374
Profitability/Solvency Ratios (%)					
ROE adjusted	14.6	25.3	8.5	8.1	11.4
Net interest margin	2.84	2.85	2.45	2.53	2.71
Cost/income ratio	33.9	34.5	38.0	36.8	34.2
Cash cost/average assets	1.9	1.7	1.5	1.4	1.4
NPLs/customer loans	10.2	12.3	13.5	14.0	13.5
Reserve for loan losses/NPLs	70.2	66.9	65.5	67.8	72.7
Bad debt prov./avg. cust. loans	3.3	3.0	2.2	2.1	1.9
Loans/deposit ratio	97.3	95.1	94.3	98.2	100.5
Tier 1 capital ratio	9.9	9.5	9.9	9.2	9.9
Total capital ratio	9.9	10.0	12.0	11.2	11.8

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Getin Noble Bank Financials

Changes in Estimates

Figure 93. Getin Noble Bank – Changes in Income Statement Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)
Net Interest Income	1,340	1,333	-0.6%	1,563	1,456	-6.8%	1,770	1,627	-8.1%
Net Fee & Commission Income	853	803	-5.9%	898	801	-10.7%	938	894	-4.7%
Financial Income	-43	-58	34.6%	-16	-16	0.0%	-16	-16	0.0%
Other Income	108	99	-8.2%	95	76	-20.1%	92	73	-20.1%
Total Revenue	2,259	2,178	-3.6%	2,540	2,318	-8.7%	2,783	2,578	-7.4%
Labour Costs	-371	-363	-2.1%	-383	-364	-5.0%	-398	-378	-5.0%
General Costs	-441	-407	-7.8%	-487	-429	-11.9%	-500	-440	-11.9%
Depreciation	-63	-63	0.4%	-65	-66	0.9%	-68	-69	0.9%
Operating Expenses	-875	-833	-4.8%	-935	-859	-8.2%	-966	-887	-8.2%
Operating Profit	1,384	1,345	-2.8%	1,605	1,459	-9.1%	1,817	1,691	-7.0%
Provision Charge	-980	-1,003	2.4%	-1,009	-1,009	0.0%	-1,062	-981	-7.6%
Share of Profits (Losses) of Associates	22	16	NM	24	14	NM	24	14	NM
Profit Before Tax	426	359	-15.9%	620	464	-25.2%	780	724	-7.2%
Minorities	-14	-14	1.2%	0	0	NA	0	0	NA
Tax	-87	-60	-30.8%	-124	-93	-25.2%	-156	-145	-7.2%
Other	84	84	0.0%	0	0	NA	0	0	NA
Net Profit	409	368	-10.0%	496	371	-25.2%	624	579	-7.2%
Diluted EPS (Zl)	0.15	0.14	-10.0%	0.19	0.14	-25.2%	0.24	0.22	-7.2%
DPS (Zl)	0.00	0.00	NA	0.00	0.00	NA	0.16	0.15	-7.2%
Average Diluted Number of Shares (m)	2,650	2,650	0.0%	2,650	2,650	0.0%	2,650	2,650	0.0%

Source: Citi Research

Figure 94. Getin Noble Bank – Changes in Balance Sheet Estimates, 2012E-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)	OLD	NEW	Chg (%)
Cash and NBP Balances	2,472	2,472	0.0%	2,522	2,522	0.0%	2,573	2,573	0.0%
Interbank placements	3,380	3,380	0.0%	3,448	3,448	0.0%	3,517	3,517	0.0%
Financial Assets & Securities	7,496	8,013	6.9%	7,385	7,902	7.0%	7,797	8,335	6.9%
Net client lending	42,691	42,696	0.0%	45,469	45,474	0.0%	47,315	47,320	0.0%
Fixed assets	175	175	0.0%	183	183	0.0%	192	192	0.0%
Other assets	1,143	1,252	9.6%	1,214	1,328	9.4%	1,271	1,390	9.3%
Total Assets	57,356	57,988	1.1%	60,220	60,857	1.1%	62,665	63,328	1.1%
Interbank borrowing	550	550	0.0%	523	523	0.0%	496	496	0.0%
Client deposits	48,964	49,688	1.5%	50,443	51,189	1.5%	51,457	52,218	1.5%
Other liabilities	3,039	3,324	9.4%	3,956	4,348	9.9%	4,790	5,237	9.3%
Minorities	2	3	33.2%	2	3	33.2%	2	3	33.2%
Equity (ex Minorities)	4,800	4,423	-7.8%	5,296	4,795	-9.5%	5,920	5,374	-9.2%
Total liabilities & Equity	57,356	57,988	1.1%	60,220	60,857	1.1%	62,665	63,328	1.1%
BVPS (Zl)	1.81	1.67	-7.8%	2.00	1.81	-9.5%	2.23	2.03	-9.2%

Source: Citi Research

Figure 95. Getin Noble Bank – Changes in Key Ratios Estimates, 2012E-2014E (Percentage)

	2012E		2013E		2014E	
	OLD	NEW	OLD	NEW	OLD	NEW
NIM on AIEA	2.47%	2.45%	2.74%	2.53%	2.97%	2.71%
NIM on Total Ave. Assets	2.40%	2.37%	2.66%	2.45%	2.88%	2.62%
Net Fee & Commission Income/Total Income	37.8%	36.9%	35.3%	34.6%	33.7%	34.7%
Net Fee & Commission Income/Deposits	1.7%	1.6%	1.8%	1.6%	1.8%	1.7%
Cost/Income	38.7%	38.2%	36.8%	37.0%	34.7%	34.4%
Cost/Avg. Assets	1.6%	1.5%	1.6%	1.4%	1.6%	1.4%
Effective tax rate	20.4%	16.7%	20.0%	20.0%	20.0%	20.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	70.0%	70.0%
Provisions/Avg Net Loans	2.34%	2.39%	2.29%	2.29%	2.29%	2.11%
Equity/Assets	8.4%	7.63%	8.8%	7.88%	9.45%	8.49%
Loans/Deposits	87.2%	85.93%	90.1%	88.84%	91.95%	90.6%
Loans/Total Assets	74.4%	73.6%	75.5%	74.7%	75.5%	74.7%
ROE	9.1%	8.5%	9.8%	8.1%	11.1%	11.4%
ROA	0.73%	0.7%	0.84%	0.6%	1.0%	0.9%
RWA/Total Assets	78.1%	77.3%	10.1%	9.2%	10.9%	9.9%
Tier I Ratio (%)	9.9%	9.9%	78.1%	77.3%	78.1%	77.3%
CAR	12.1%	12.0%	12.2%	11.2%	12.8%	11.8%
Bank Employees	5,408	5,354	5,408	5,354	5408	5,354

Source: Citi Research

Financials

Figure 96. Getin Noble Bank – Income Statement, 2008-2014E (Polish Zloty in million)

	2008	2009	chg (%)	2010	chg (%)	2011	chg (%)	2012E	chg (%)	2013E	chg (%)	2014E	chg (%)
Net Interest Income	601	784	30.5%	1,052	34.2%	1,344	27.7%	1,333	-0.8%	1,456	9.3%	1,627	11.7%
Net Fee & Commission Income	444	714	61.0%	962	34.6%	869	-9.6%	803	-7.6%	801	-0.3%	894	11.6%
Financial Income	512	215	-57.9%	121	-43.8%	199	64.6%	33	-83.6%	56	72.2%	53	-5.1%
Other Income	15	19	27.7%	24	27.9%	-7	NA	9	NA	4	-56.6%	4	0.0%
Total Revenue	1,571	1,732	10.2%	2,159	24.6%	2,405	11.4%	2,178	-9.5%	2,318	6.4%	2,578	11.2%
Labour Costs	-262	-225	-14.2%	-297	32.0%	-351	18.4%	-363	3.3%	-364	0.3%	-378	3.9%
General Costs	-302	-353	16.7%	-382	8.4%	-422	10.4%	-407	-3.5%	-429	5.4%	-440	2.7%
Depreciation	-39	-48	22.7%	-54	10.9%	-60	11.5%	-63	5.3%	-66	4.3%	-69	4.1%
Operating Expenses	-604	-626	3.7%	-733	17.0%	-833	13.7%	-833	0.0%	-859	3.1%	-887	3.3%
Operating Profit	967	1,106	14.4%	1,426	28.9%	1,572	10.3%	1,345	-14.5%	1,459	8.5%	1,691	15.9%
Provision Charge	-332	-795	139.7%	-1,057	32.9%	-1,208	14.3%	-1,003	-17.0%	-1,009	0.6%	-981	-2.8%
Associate Income	0	0	NA	0	NA	10	NA	16	66.9%	14	-15.6%	14	0.0%
Profit Before Tax	636	311	-51.1%	369	18.6%	374	1.4%	359	-4.1%	464	29.5%	724	56.0%
Tax	-112	3	NA	12	345.8%	-66	NA	-60	-9.4%	-93	54.7%	-145	56.0%
Profit After Tax	524	314	-40.1%	381	21.4%	307	-19.3%	298	-2.9%	371	24.4%	579	56.0%
Minorities	-4	-5	11.3%	-10	118.2%	0	NA	-14	NA	0	NA	0	NA
Discontinued activity	0	0	NA	80	NA	642	707.2%	84	-87.0%	0	NA	0	NA
Net Profit	519	309	-40.5%	450	45.7%	950	111.1%	368	-61.3%	371	1.0%	579	56.0%
Diluted EPS (Zl)	0.53	0.13	-74.7%	0.18	36.9%	0.37	102.9%	0.14	-62.7%	0.14	1.0%	0.22	56.0%
Average Diluted Number of Shares (m)	979	2,305	135.4%	2,453	6.4%	2,552	4.0%	2,650	3.9%	2,650	0.0%	2,650	0.0%

Source: Company reports, Citi Research estimates

Figure 97. Getin Noble Bank – Balance Sheet, 2008-2014E (Polish Zloty in million)

	2008	2009	chg (%)	2010	chg (%)	2011	chg (%)	2012E	chg (%)	2013E	chg (%)	2014E	chg (%)
Cash and NBP Balances	647	909	40.6%	1,976	117.3%	2,423	22.7%	2,472	2.0%	2,522	2.0%	2,573	2.0%
Interbank placements	2,648	1,069	-59.6%	2,601	143.2%	3,313	27.4%	3,380	2.0%	3,448	2.0%	3,517	2.0%
Financial Assets & Securities	3,364	4,261	26.7%	2,887	-32.2%	4,650	61.1%	5,767	24.0%	5,115	-11.3%	4,846	-5.2%
Net client lending	21,497	25,584	19.0%	33,454	30.8%	41,056	22.7%	42,696	4.0%	45,474	6.5%	47,320	4.1%
Fixed assets	154	138	-10.5%	179	30.0%	159	-11.3%	175	10.0%	183	5.0%	192	5.0%
Other assets	425	1,248	193.9%	1,702	36.3%	2,905	70.7%	3,498	20.4%	4,115	17.6%	4,879	18.5%
Total Assets	28,733	33,208	15.6%	42,798	28.9%	54,488	27.3%	57,988	6.4%	60,857	4.9%	63,328	4.1%
Interbank borrowing	1,276	738	-42.2%	713	-3.3%	579	-18.8%	550	-5.0%	523	-5.0%	496	-5.0%
Client deposits	20,017	28,237	41.1%	37,026	31.1%	47,059	27.1%	49,688	5.6%	51,189	3.0%	52,218	2.0%
Other liabilities	4,758	1,260	-73.5%	1,763	40.0%	2,622	48.7%	3,324	26.7%	4,348	30.8%	5,237	20.4%
Minorities	9	3	-63.4%	2	-35.5%	2	17.2%	3	11.8%	3	0.0%	3	0.0%
Equity (ex Minorities)	2,673	2,890	8.1%	3,294	14.0%	4,225	28.3%	4,423	4.7%	4,795	8.4%	5,374	12.1%
Total liabilities & Equity	28,733	33,208	15.6%	42,798	28.9%	54,488	27.3%	57,988	6.4%	60,857	4.9%	63,328	4.1%
Interest Earning Assets	28,154	32,390	15.0%	41,656	28.6%	52,806	26.8%	56,089	6.2%	58,864	4.9%	61,254	4.1%
BVPS (Zl)	2.7	1.3	-54.1%	1.3	7.1%	1.6	18.7%	1.7	4.7%	1.8	8.4%	2.0	12.1%

Source: Company reports, Citi Research estimates

Figure 98. Getin Noble Bank – Key Ratios, 2008-2014E (Percentage)

	2008	2009	2010	2011	2012E	2013E	2014E
NIM on AIEA	2.82%	2.59%	2.84%	2.85%	2.45%	2.53%	2.71%
NIM on Total Ave. Assets	2.09%	2.53%	2.77%	2.76%	2.37%	2.45%	2.62%
Net Fee & Commission Income/Total Income	28.2%	41.2%	44.5%	36.1%	36.9%	34.6%	34.7%
Net Fee & Commission Income/Deposits	2.2%	2.5%	2.6%	1.8%	1.6%	1.6%	1.7%
Cost/Income	38.4%	36.1%	33.9%	34.6%	38.2%	37.0%	34.4%
Cost/Avg. Assets	2.1%	2.0%	1.9%	1.7%	1.5%	1.4%	1.4%
Effective tax rate	17.6%	-0.9%	-3.3%	17.7%	16.7%	20.0%	20.0%
Provisions/Avg Net Loans	2.10%	3.38%	3.58%	3.24%	2.39%	2.29%	2.11%
Equity/Assets	9.3%	8.7%	7.7%	7.8%	7.6%	7.9%	8.5%
Loans/Deposits	107.4%	90.6%	90.4%	87.2%	85.9%	88.8%	90.6%
Loans/Total Assets	69.7%	85.0%	86.5%	75.3%	73.6%	74.7%	74.7%
ROE	25.4%	11.1%	14.6%	25.3%	8.5%	8.1%	11.4%
ROA	1.8%	1.0%	1.2%	2.0%	0.7%	0.6%	0.9%
CAR (%)	13.8%	11.1%	9.9%	10.0%	12.0%	11.2%	11.8%
Group Employees	3,945	4,409	5,640	5,408	5,354	5,354	5,354

Source: Company reports, Citi Research estimates

PKO BP

Company description

PKO BP is Poland's largest bank, with c1,250 branches. It has about 12% market share of total banking assets and is dominant in retail banking with c.27% retail deposit market share and c35% mortgage lending market share. PKO BP is 44% owned (directly and through state-controlled bank BGK) by the Polish state.

Investment strategy

We like the bank's strategy to base the growth of the business on growing lending coupled with its strong retail franchise, giving it the access to relatively cheap and stable funding. We note, however, that in the short term the aggressive lending strategy may lead to high provisioning but in our opinion that risk is already priced in. We view the stock as fairly valued and rate PKO BP Neutral.

Valuation

Our Standard Warranted Equity Valuation of ZI 38.1 per share is based on the formula: $\text{Price} / \text{Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$. Our sustainable ROE estimate is 14.5%. We use a cost of equity of 10.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 45.7 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital). We set our target price at ZI 38.1 using the more conservative short-term approach.

Risks

The following risk factors might impede the share price from reaching our target price. The macro economy may perform better or worse than anticipated and lead to higher or lower provisioning and slower or higher loan growth than anticipated. Specific to the bank: 1) state ownership may constrain management's ability to restructure the business, particularly its ability to decrease employee levels, and impact the bank's capitalisation; 2) the bank was active in extending FX-denominated loans to retail customers, who could face repayment difficulties; and 3) margin developments have been volatile recently and future margin development could be better or worse than we expect.

Bank Pekao SA

Company description

Bank Pekao is Poland's second-largest bank, 59.4% owned by UniCredit. The bank has c.12% asset market share, 1,058 outlets, and serves c.5m customers.

Investment strategy

Given Pekao's overcapitalization (Core Tier 1 of 18.7% in 3Q12) the crucial question is if and when Pekao's surplus capital (c.ZI 8-9bn assuming normalized capital at Tier 1 equals 10%) is utilized and how it will be used. Given the slowdown in the economy, we doubt that the bank will be able to achieve significant loan growth. More likely, in our view, is Pekao taking advantage of M&A opportunities, if they appear. However, we think the market price reflects greater growth opportunities than we envisage and we rate the stock Sell.

Valuation

Our Standard Warranted Equity Valuation of ZI 135 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 13.0%, a sustainable growth rate of 4.5% and a cost of equity of 10.0%. Given the bank's overcapitalization (Tier 1 at 18.7%), we value the bank also on the capital-adjusted base and, assuming capital normalised ROE of 18.5%, arrive at fair value of ZI 167 per share on this basis. Our Economic Value Added Valuation of ZI 172 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital). We set our target price at ZI 148 using a weighted average of our standard Warranted Equity Valuations based on reported (60% weight) and capital-normalised (40% weight) ROE.

Risks

The following risk factors could cause the share price to deviate significantly from our target price: 1) the bank's conservative risk and capital management may lead to lower lending growth and dividend payment than we anticipate and 2) provisioning, low in the last slowdown (2009), could surprise negatively in the next slowdown/recession period due to a lower buffer of over-provisioning. Upside risks include 1) utilization of surplus capital (most likely through attractive M/A), 2) better than expected quality of lending leading to lower provisioning and/or 3) a rebound in inflows to equity investment funds.

Bank Zachodni WBK

Company description

Bank Zachodni WBK SA is Poland's fifth-largest bank by assets, with a market share of 5%. It has historically focused on servicing medium-sized companies and retail clients. In 2011 Allied Irish Banks PLC sold its 70.5% strategic stake in Bank Zachodni WBK to Santander.

In February 2012 Santander and KBC announced plans to merge their Polish subsidiaries, BZ WBK and Kredyt Bank, to create the third biggest in assets bank in Poland. The merger is expected at the end of 2012-beginning of 2013.

Investment strategy

We like BZ WBK's income diversification but note the bank's continued weakness in investment fund business, in the past being one of the core businesses for the bank. However, as we expect the upcoming merger with Kredyt Bank may bring significant synergies (mainly on cost side) we rate the stock Buy.

Valuation

Our Standard Warranted Equity Valuation of ZI 245 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 16% and use a cost of equity of 10.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 294 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital).

Due to the announced merger of BZ WBK with Kredyt Bank, our target price of ZI 266 per BZ WBK share is based on the parity and our valuation of the merged bank (assuming sustainable ROE at 16%, cost of equity at 10.0% and sustainable growth rate at 4.5%).

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 higher 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) that 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.

Kredyt Bank SA

Company description

Kredyt Bank, 80% owned by KBC Group, is Poland's ninth-largest bank by assets. In February 2012 Santander and KBC announced plans to merge their Polish subsidiaries, BZ WBK and Kredyt Bank, to create the third biggest in assets bank in Poland.

Investment strategy

Currently Kredyt Bank's main weakness is its balance sheet structure (high share of low-margin pre-crisis FX mortgage loans funded by funding from the parent) and low number of clients in the close banking relation, generating recurring fee income. But we believe the upcoming merger with BZ WBK, one of the best managed banks in Poland, creates significant upside potential and therefore we rate the stock Buy.

Valuation

Our Standard Warranted Equity Valuation of ZI 6.8 per share is based upon 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 8.0% and use a cost of equity of 11.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 6.2 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital).

Due to the announced merger at an exchange ratio 6.96 BZ WBK shares for 100 Kredyt Bank shares, our target price of ZI 18.5 per Kredyt Bank share is based on the parity and our valuation of the merged bank.

Risks

Risks relating to the Polish banking market include: (1) the Polish banking market is rather fragmented and increased competition could put more pressure on margins and earnings than we currently expect. (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. Specific to the bank we outline that: (1) historically profitability was lower than its peer group; (2) due to its lower market share, there is a risk that Kredyt Bank will be more affected by rising competition than peers; (3) the bank is heavily dependent on KBC support. Additionally, the achievement of our target price depends on successful completion of the merger process and achieving expected synergies.

BRE Bank SA

Company description

BRE Bank (70% owned by Commerzbank) is the third-largest Polish bank, with a market share of approximately 8% of banking assets. Historically, it has focused on commercial banking, although since 2001 it has been expanding its retail business, from 8% of its lending in 2000 to 50% in 2008.

Investment strategy

What we like in the bank is the focus on tight cost management, its low exposure to the most troubled construction companies and mBank's business model of consumer finance (based on lending to current clients). However, these positives are offset by the high share of low-margin but capital-intensive FX mortgage loans in the balance sheet that we expect will be a continuous drag on future ROE. We perceive the market price as too high and rate the stock Sell.

Valuation

Our Standard Warranted Equity Valuation of ZI 279 per share is based upon the formula: $\text{Price / Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$. We assume a sustainable return on equity of 11.5%, a cost of equity of 10.5% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 294 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital, assuming no capital increase) and the proposed value of capital increase. In line with the approach we adopt for the rest of our coverage universe, our target price is based upon the shorter-term approach, and is set at ZI 279.

Risks

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

ING Bank Slaski SA

Company description

ING Bank Slaski is Poland's fourth-largest bank by assets, with a market share of about 6%. It is a universal bank and has been operating since 1989. The bank is particularly strong in southern Poland, but is present nationwide. ING Bank NV holds a 75% stake in ING Bank Slaski. The bank cooperates closely with ING Group's investment management, life insurance and pension fund businesses in Poland.

Investment strategy

With the lowest loan-to-deposit ratio in Citi Research's CEEMEA universe and the third-largest retail deposit base in the sector, the bank has been particularly well positioned to benefit from the current environment where most banks were more focused on liquidity rather than on growing balance sheets. We believe though, that the bank's competitive advantages are already reflected in its share price and we rate the stock Neutral.

Valuation

Our Standard Warranted Equity Valuation of ZI 92 per share is based on the formula: $\text{Price} / \text{Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$. Given higher regulatory charges, we set our assumption of sustainable ROE at 13.0% and use a cost of equity of 10.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 109 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital). Similar to other Polish banks, we set our target price using the short-term approach at ZI 92.

Risks

The following risk factors might cause the share price to deviate from our target price. The macro economy may perform better or worse than anticipated and lead to higher or lower provisioning and slower or higher loan growth than anticipated. Specifically for ING Bank Śląski, we highlight: (1) that despite the bank's strong liquidity its net interest margin may be more negatively affected by increased competition for deposits than we expect; and (2) despite focus on mortgage lending and lending to municipalities, the cost of risk may surprise negatively.

Bank Millennium SA

Company description

Bank Millennium, majority owned by Banco Comercial Portugues, is a medium-sized Polish bank with over 1 million customers and a strong market position in retail mortgage loans, credit cards and leasing services.

Investment strategy

Over the past several years, Bank Millennium has built a strong position in CHF-denominated mortgage lending, increased the sale of consumer finance products and developed a successful customer deposit collection franchise. In 4Q08, Millennium's CHF mortgage business model collapsed as a result of decreased availability of FX swaps and significantly rising FX swap costs. As a result, we anticipate that the profitability of the bank (we assume 11% sustainable ROE) will remain below the bank's cost of risk (11.5%) and thus we rate the stock Sell.

Valuation

Our Standard Warranted Equity Valuation of ZI 3.7 per share is based upon the formula: $\text{Price} / \text{Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$. We assume a sustainable ROE of 10.0% and use a cost of equity of 11.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 4.03 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital). In line with the approach we adopt for the rest of our coverage universe, our target price is based upon the shorter-term approach at ZI 3.7.

Risks

The economy may perform better or worse than anticipated and lead to higher or lower provisioning and slower or higher loan growth than anticipated. Additionally, the Polish banking market is rather fragmented and increased competition could put more pressure on margins and earnings than currently expected. Specifically for Bank Millennium: (1) it is more dependent on short-term retail funding than its Polish peers, leaving it exposed to higher funding costs; and (2) the bank is the most exposed in our Polish banking coverage universe to CHF-denominated mortgages and thus vulnerable to continued zloty weakness. 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.

Getin Noble Bank

Company description

In 2011 Getin Noble Bank was the 7th biggest Polish bank by assets, 5th by loans and 5th by deposits. GNB specialises in retail lending (namely mortgage, car and cash loans), and was the parent company for the group consisting of an asset manager, brokerage and leasing company as well as owner of a 48.85% stake in financial intermediary Open Finance.

In June 2012 Getin Noble Bank was merged with the parent company, Get Bank (former Allianz Bank, acquired by Getin Holding in 2011). From a legal point of view the new bank is the successor of Get Bank but it was re-named Getin Nobel Bank and continues the business of the former Getin Noble Bank (prior to the merger Get Bank practically hadn't conducted any banking activity).

Investment strategy

We view positively the strategic changes that have led Getin Noble Bank (GNB) to provide fewer mortgages, grant more cash loans and improve its funding mix. But we don't expect the bank will be able to maintain its current momentum; indeed, recent positive results are not unprecedented and performance has just returned to where it was in the past. After the recent strong share performance, we view the stock as fairly valued and thus we rate GNB Neutral/High Risk.

Valuation

We value Getin Noble Bank using a Standard Warranted Equity Valuation and an Economic Value Added Valuation. These are standard methods that we use when valuing our coverage universe of listed Polish banks.

Our Standard Warranted Equity Valuation model is based upon the formula: $\text{Price / Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$. Our WEV approach suggests a valuation of ZI 1.81 per share. When valuing Getin Noble Bank we assume a sustainable ROE of 11.0%. We assume a cost of equity of 11.0% (in line with our methodology of setting cost of equity for Polish banks within a range of 10.0% to 11.0%, depending on the bank's exposure to CHF lending) and a sustainable growth rate of 4.5%. Based on these inputs, we arrive at a valuation of ZI 1.81 per share for Getin Noble Bank.

Our Economic Value Added (EVA) model arrives at a valuation by adding discounted EVA flows (adjusted profits minus required capital charges) to adjusted starting book value. A terminal value is calculated using a standard perpetuity

formula using forecast EVA flows to 2015 and an assumption of discount rate and a perpetual growth rate. Assuming a discount rate of 11.0% and perpetual growth at 4.5%, we arrive at a valuation of ZI 2.08 per share.

As with other Polish banks, we set our target price of ZI 1.81 on the basis of the more conservative Standard Warranted Equity Valuation.

Risks

The following risk factors might cause the share price to deviate from our target price. The macro economy may perform worse or better than anticipated and lead to higher/lower provisioning and slower/faster loan growth than anticipated. Specifically for Getin Noble Bank, we highlight that: 1) the bank's loan book is heavily weighted towards FX mortgage loans such that a weaker zloty could negatively impact asset quality; 2) the bank remains highly dependent on revenues from selling insurance products which could be affected by the potential regulation of the bancassurance market; 3) the bank remains highly dependent on revenues from selling insurance products of TU Europa, which could be affected by the potential regulation of the bancassurance market; 4) due to the importance of mortgage loans within its business mix (mortgages consist about 74% of Getin Noble Bank's loans), the bank carries above-average exposure to property price risks in Poland. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target price.

Appendix A-1

Analyst Certification

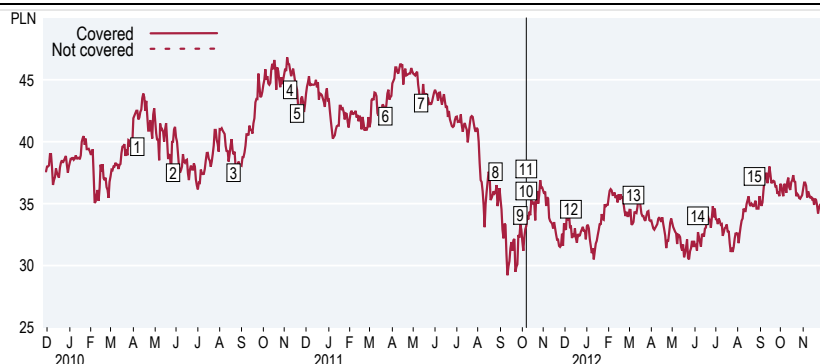
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each 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

PKO BP (PKO.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	*1L	*48.40	42.50
2	27-May-10	1L	*49.00	40.00
3	20-Aug-10	1L	*54.00	38.98
4	9-Nov-10	1L	*55.00	45.76
5	18-Nov-10	1L	*60.00	44.19

* Indicates change

	Date	Rating	Target Price	Closing Price
6	23-Mar-11	1L	*55.50	42.40
7	12-May-11	*2L	*47.70	43.35
8	25-Aug-11	*1L	*42.90	35.90
9	29-Sep-11	1L	*41.00	33.32
10	7-Oct-11	Stock rating system changed		

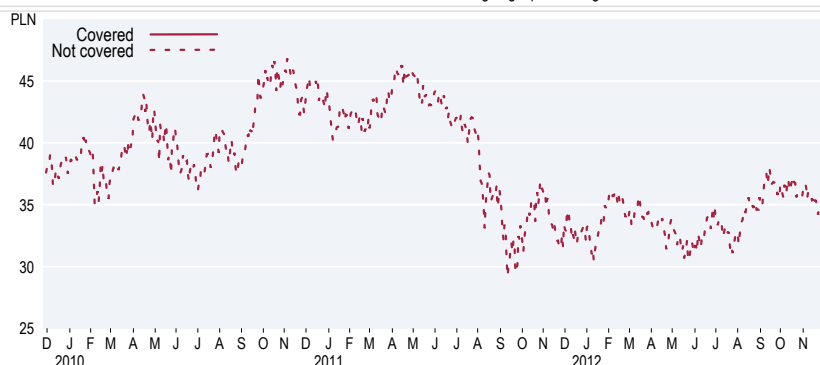
	Date	Rating	Target Price	Closing Price
11	7-Oct-11	*1	41.00	33.20
12	9-Dec-11	1	*41.80	33.15
13	7-Mar-12	1	*42.70	33.52
14	6-Jun-12	1	*39.70	32.70
15	24-Aug-12	1	*40.70	34.99

Rating/target price changes above reflect Eastern Standard Time

PKO BP (PKO.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

BRE Bank SA (BREP.WA)

Ratings and Target Price History

Fundamental Research

Analyst: Andrzej Powierza
Covered since March 2 2011



	Date	Rating	Target Price	Closing Price
1	2-Mar-10	*1M	*242.77	201.90
2	7-Apr-10	*2M	*268.37	241.00
3	27-May-10	*1M	*279.00	247.20
4	16-Aug-10	*2M	*273.00	245.00
5	13-Oct-10	*3M	273.00	274.50
6	18-Nov-10	*2M	*337.00	294.90

* Indicates change

	Date	Rating	Target Price	Closing Price
7	23-Mar-11	2M	*364.00	328.00
8	3-Jun-11	2M	*351.00	338.90
9	19-Aug-11	2M	*318.00	248.60
10	30-Sep-11	*1M	*298.00	242.00
11	7-Oct-11	Stock rating system changed		
12	7-Oct-11	*1	298.00	239.30

	Date	Rating	Target Price	Closing Price
13	9-Dec-11	*3	*243.00	254.70
14	22-Feb-12	3	*268.00	295.60
15	6-Jun-12	*2	*266.00	262.90
16	10-Aug-12	*3	*273.00	319.50

Rating/target price changes above reflect Eastern Standard Time

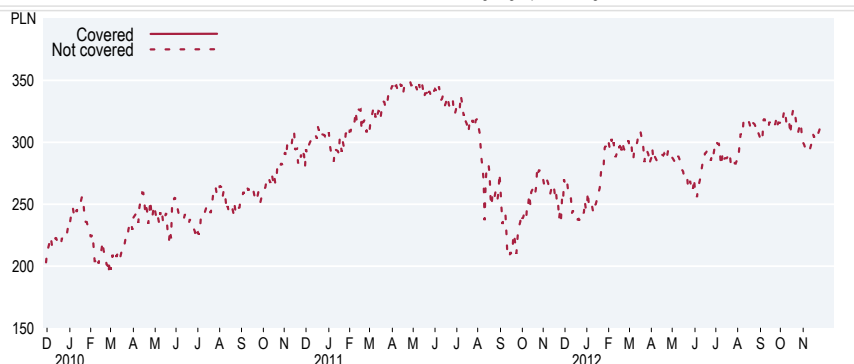
BRE Bank SA (BREP.WA)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Andrzej Powierza
Covered since March 2 2011



* Indicates change

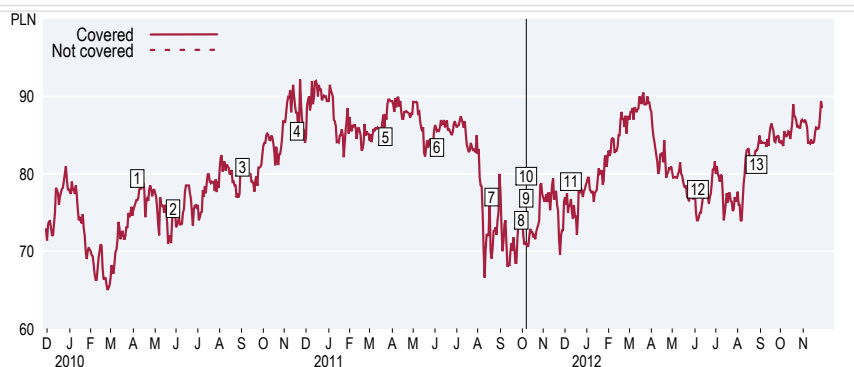
Rating/target price changes above reflect Eastern Standard Time

ING Bank Slaski SA (BSK.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	*77.70	76.60
2	27-May-10	*2M	*80.90	75.50
3	2-Sep-10	*3M	*82.30	80.85
4	18-Nov-10	3M	*92.00	88.00
5	23-Mar-11	3M	*89.50	87.70

* Indicates change

	Date	Rating	Target Price	Closing Price
6	3-Jun-11	3M	*89.90	85.50
7	19-Aug-11	*1M	*93.00	69.05
8	30-Sep-11	1M	*88.60	74.00
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*1	88.60	71.00

	Date	Rating	Target Price	Closing Price
11	9-Dec-11	1	*92.00	76.75
12	6-Jun-12	1	*89.00	74.00
13	28-Aug-12	*2	*88.20	83.00

Rating/target price changes above reflect Eastern Standard Time

ING Bank Slaski SA (BSK.WA)

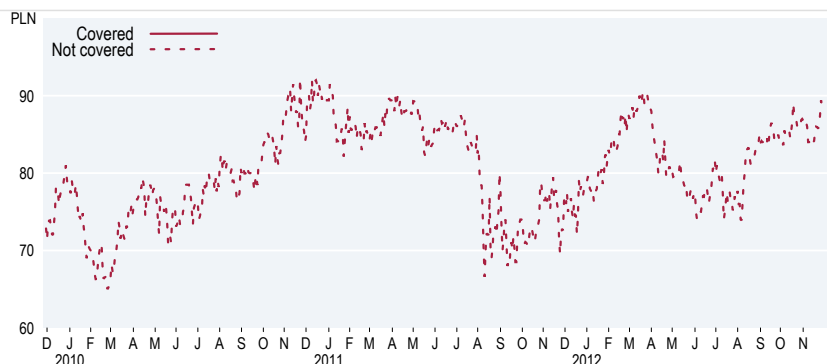
Ratings and Target Price History

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

Bank Zachodni WBK (BZW.WA)

Ratings and Target Price History

Fundamental Research

Analyst: Andrzej Powierza

Covered since March 2 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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

Date	Rating	Target Price	Closing Price
6 23-Mar-11	2M	*251.70	225.70
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		

Date	Rating	Target Price	Closing Price
11 7-Oct-11	*2	239.00	222.00
12 9-Dec-11	2	*229.00	229.70
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

Bank Zachodni WBK (BZW.WA)

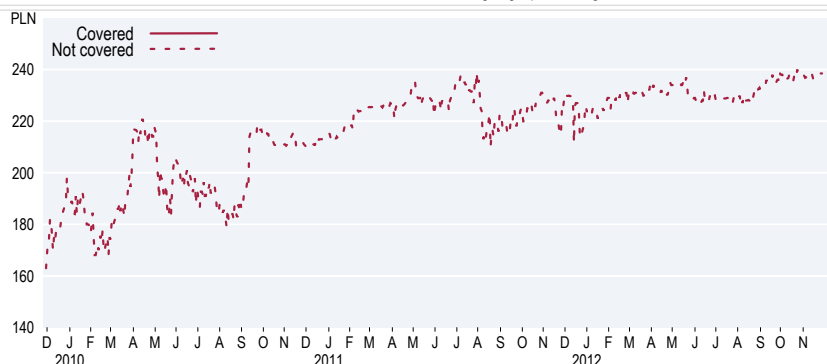
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Andrzej Powierza

Covered since March 2 2011



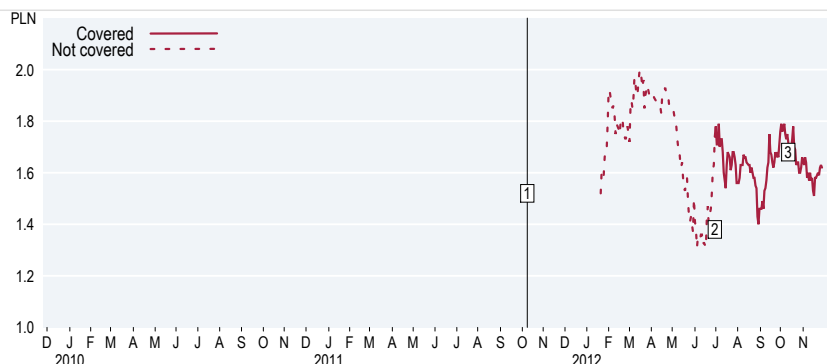
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Getin Noble Bank (GNB.WA)

Ratings and Target Price History Fundamental Research

Analyst: Andrzej Powierza
Covered since June 29 2012



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
2	29-Jun-12	*1	*1.95	1.74

	Date	Rating	Target Price	Closing Price
3	11-Oct-12	*2	*1.82	1.72

Rating/target price changes above reflect Eastern Standard Time

Getin Noble Bank (GNB.WA)

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

Analyst: Andrzej Powierza
Covered since June 29 2012



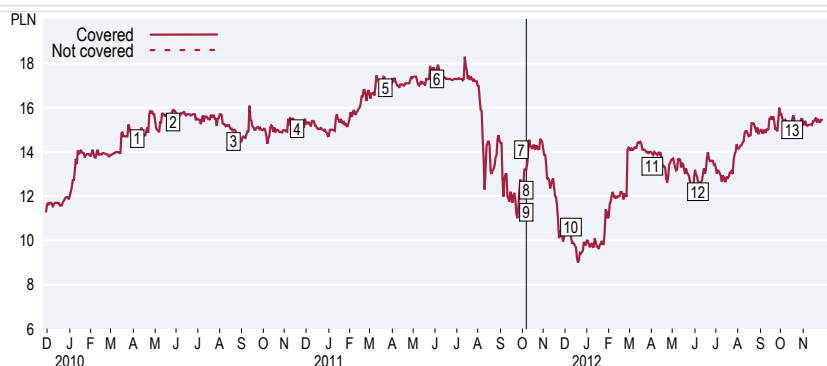
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Kredyt Bank SA (KRB.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	*15.60	14.80
2	27-May-10	3M	*16.00	15.92
3	20-Aug-10	3M	*15.10	15.00
4	18-Nov-10	3M	*16.00	15.40
5	23-Mar-11	3M	*16.40	17.01

* Indicates change

	Date	Rating	Target Price	Closing Price
6	3-Jun-11	3M	*16.10	17.78
7	30-Sep-11	3M	*12.00	12.50
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*3	12.00	13.20
10	9-Dec-11	3	*9.20	10.19

	Date	Rating	Target Price	Closing Price
11	3-Apr-12	*1H	*18.80	13.90
12	6-Jun-12	1H	*18.40	12.66
13	17-Oct-12	1H	*18.30	15.46

Rating/target price changes above reflect Eastern Standard Time

Kredyt Bank SA (KRB.WA)

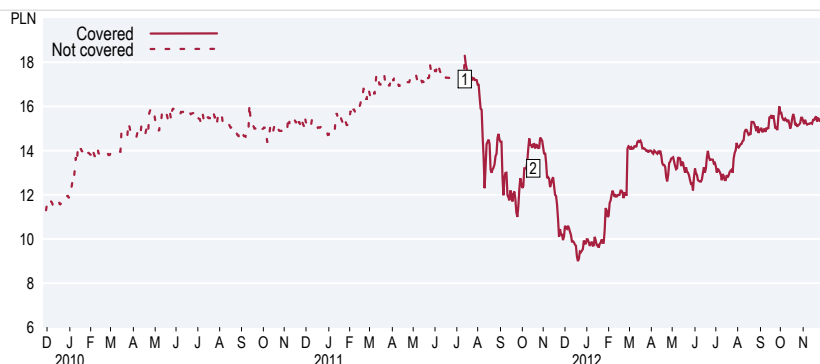
Ratings and Target Price History

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Relative Call (3 Month)

Analyst: Andrzej Powierza

Covered since March 2 2011



	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD LP	-	18.30

* Indicates change

	Date	Rating	Target Price	Closing Price
2	18-Oct-11	*REM LP	-	14.29

Rating/target price changes above reflect Eastern Standard Time

Bank Millennium SA (MILP.WA)

Ratings and Target Price History

Fundamental Research

Analyst: Andrzej Powierza

Covered since March 2 2011



	Date	Rating	Target Price	Closing Price
1	25-Jan-10	3M	*3.89	4.28
2	7-Apr-10	3M	*4.40	4.44
3	27-May-10	3M	*4.70	4.69
4	2-Aug-10	3M	*4.65	4.69
5	18-Nov-10	3M	*5.14	5.11
6	23-Mar-11	3M	*5.49	5.60

* Indicates change

	Date	Rating	Target Price	Closing Price
7	3-Jun-11	3M	*5.67	5.46
8	8-Aug-11	3M	*5.00	4.14
9	30-Sep-11	3M	*4.53	4.60
10	7-Oct-11	Stock rating system changed		
11	7-Oct-11	*2	4.53	4.39
12	9-Dec-11	2	*3.80	3.69

	Date	Rating	Target Price	Closing Price
13	5-Mar-12	*3	*4.10	4.33
14	6-Jun-12	*2	*3.82	3.24
15	27-Jul-12	*1	*3.85	3.40
16	17-Oct-12	*3	3.85	4.40

Rating/target price changes above reflect Eastern Standard Time

Bank Millennium SA (MILP.WA)

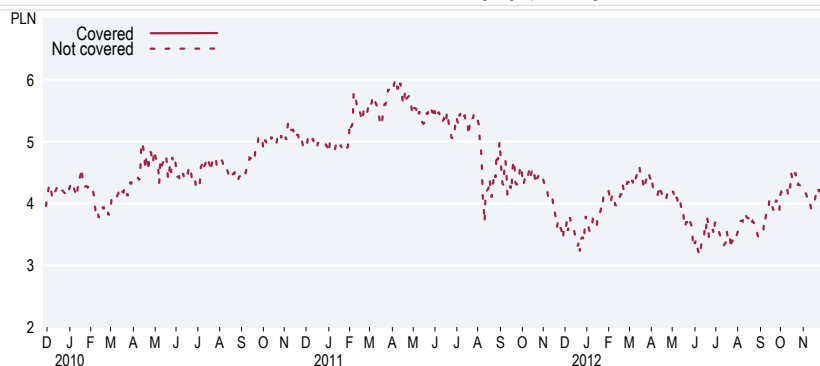
Ratings and Target Price History

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

Bank Pekao SA (PEO.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	2L	*192.00	172.90
2	27-May-10	*1L	*179.50	161.60
3	16-Aug-10	1L	*183.00	166.90
4	13-Oct-10	*2L	183.00	188.00
5	18-Nov-10	2L	*201.00	185.00

* Indicates change

	Date	Rating	Target Price	Closing Price
6	23-Mar-11	*1L	*195.30	166.50
7	3-Jun-11	1L	*186.00	168.00
8	19-Aug-11	1L	*190.00	129.60
9	30-Sep-11	1L	*171.00	134.20
10	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
11	7-Oct-11	*1	171.00	140.00
12	27-Mar-12	1	*173.00	156.60
13	6-Jun-12	1	*157.00	139.00
14	21-Aug-12	*2	*152.00	157.00

Rating/target price changes above reflect Eastern Standard Time

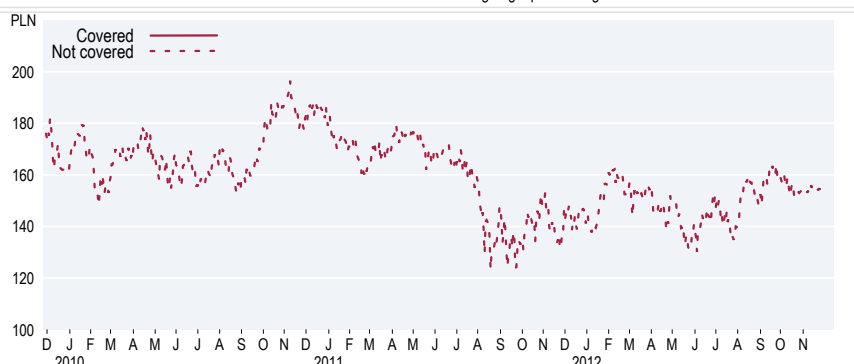
Bank Pekao SA (PEO.WA)

Ratings and Target Price History

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