Sector Report CEE Banks: Eastern trail

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EU accession and foreign ownership have helped to create a sustainable solid banking sector, while the CIS part of the sector is still facing some political uncertainties. Prospering markets have propelled bank-ing results and will continue to do so. However, regional markets can be split into different levels of de-velopment, also differentiating the demand for banking products.

We have categorized markets into "Emerging" (RU, RO, UA, etc) and "Developing" (e.g. HU, PL, CZ), while Aus-tria as part of Euroland is seen as a "Mature" market. While the difference for the first two categories comes from product types, both categories have strong growth rates in common. Convergence to "Mature" market levels will boost total banking assets from 67% of GDP for CEE-14 (SI 117% - RO 51%) to Euroland levels of 236% over time. Mortgage and consumer loans should remain the growth drivers, while the confidence in foreign names should help draining money away from piggy banks. While latest EU joiners Romania and Bulgaria should offer highest growth rates – along with Russia and Ukraine – "Developing" markets such as Poland offer still substantial upside in wealth management. Mutual fund holdings in Poland are at some 6% of GDP compared to 69% in Euro-land. A similar picture is given by the live insurance segment, where premium income hovers around 1.5% of GDP, again much less than the 5% in Euroland.

Apart from Basel II – impacting the entire industry – booming markets in countries such as Serbia, Croatia, Ro-mania and Bulgaria have experienced the introduction of severe credit growth limitations in order to curb external imbalances. Measures range from limits on annual credit growth to reserve requirements (focus on FX assets). While Romania and Bulgaria were able to even ease restrictions somewhat, countries such Croatia and Serbia are still facing tight rules.

With mostly all market players (namely internationals) focusing on retail and SME business, competition became tight, with a corresponding pressure on margins. Since hardly any M&A targets were left in CE, the majority of M&A activities were observable in SEE and CIS region. Further business expansion was done through enlarge-ment of branch networks. Local banks, in the CIS region, especially the big players in Russia, stayed away form the consolidation process and concentrated their resources on the high growth potential in their domestic market. All top 10 CEE players together have a market share of 45%. A potential merger of UniCredit and Société Gé-nérale might revive the M&A market again, by making some parts of the respective groups available for sale for antitrust reasons.

In terms of valuation/recommendations we somehow have split the region into the Polish part and the rest of the region. OTP remains undoubtedly our top pick for the sector offering double digit growth at a reasonable price. The stock still trades at discounts of 31% to 35% to its regional peers and raising our target price to HUF 11,600, we maintain our buy rating. We reiterate our accumulate call for Komercni banka (raised target price to CZK 4,400). Even though the firm is certainly not a strong growth producer it still trades at unjustified discounts of a-bout 30% to regional peers. Broadest regional expansion and an increasing focus on retail and SMEs along with the planning expansion of its branch network paves the way for a strong growth outlook (26% CAGR bottom line). On a reviewed target price of EUR 122, however, upside potential is limited. Maintain accumulate. We see FHB rather driven by speculation on a takeover and have consequently a premium of 30% added to the fundamentally derived target price (HUF 2,330, Hold).

Polish banks across the board trade at the higher end of valuations. The size of the country, as well as the poten-tial in its retail market – increasingly in wealth management – along with the superior liquidity/demand situation on the Polish stock market. Polish banks trade at premiums of up to 25% to the peer group. Supported by good mac-ro economics, the Polish banking sector is one of the most dynamic these days and offers an attractive risk profile compared to the pure CIS plays. We think that for some banks the high valuations are justified, given their favour-able business model such BZ WBK – focus on asset management or future market position like the new Pekao, which is about to become Poland's new No 1. For both stocks we lift our rating up to Accumulate on target prices of PLN 360 and PLN 300, respectively. We see BPH's position as somewhat uncertain until the integration is completed and value it at PLN 1,000 – Hold. PKO BP benefits from its strong retail position, but depends on im-plementing its new strategy to fend off aggressive second tier banks (target price PLN 55, hold).

Top Picks: OTP, Raiffeisen International, BZ WBK, Pekao, Komercni banka