Nordea Bank Polska S. A.

A Strategic and Financial Valuation of a Bank in a Former Soviet Country

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Executive Summary

The main goal of this thesis was to determine the value of Nordea Bank Polska S.A. The foundation of the valuation was build on a strategic analysis of Poland, the Polish banking sector and Nordea Poland. Furthermore, a financial analysis was carried out to illustrate the banks historical performance. To perform the valuation of Nordea Poland, it was decided to use a equity cash flow model. The chosen model was altered slightly to reflect the great importance that capital requirements have on banks in today's financial world.

The strategic analysis showed that Poland has been undergoing a rapid transformation during the last decades. Poland's economic foundation is currently very strong and the outlook is positive. GDP figures in the country are currently among the highest in Europe and issues such as consumer spending, foreign direct investments and the trade balance are the main drivers. The analysis furthermore showed, that the banking sector in Poland has been growing rapidly and is characterised by fierce competition following an extraordinary increase of foreign banks. The sector has become increasingly westernised and the demand for financial services and lending is steadily increasing.

The strategic analysis of Nordea Poland showed, that the bank has been successful in transferring and incorporating the strong and solid banking model of the mother company. This has given the bank an advantage over other core competitors in the sector, allowing the bank to attract an increased amount of customers and thus achieve its main goal of growth. This tendency is also reflected in the financial performance of the bank.

The financial analysis showed that Nordea Poland's performance in the last years has been remarkable. The bank has been able to increase its net income with 7,5 times in a period of six years, and the loan portfolio has grown with an average of 40% in the same period. This was also reflected when comparing the bank to its main peers, where Nordea Poland especially during the financial downturn has performed exceptionally well.

Approaching the valuation, it was estimated that Nordea Poland will be able to grow at the same pace at which the bank has been doing for the last years. Most of growth is estimated to be caused by a dramatic increase in the banks loan portfolio, especially in terms of mortgage loans. Following this, net income is expected to grow 2,5 times in the next four years. Additionally, the bank is estimated to increase its income from fees and commission following a general growth in the banks customer base.

The theoretical share price of Nordea Poland was calculated to be PLN 49,26 on the 31st of December. In comparison to its peers, it was found that Nordea Poland's share price is very cheap. However, this was mostly explained by the fact that the bank currently is in a different phase than many of its peers, and the prices thus are not easily comparable. Nordea Poland's current share trades at PLN 40,10, and the share thus has an upside potential of nearly 23%. As the valuation showed that the share has a strong upside, the initial recommendation is to buy the share.

Acknowledgement

I would like to acknowledge the great and professional help that many of my colleagues have been giving me throughout the process of writing this thesis. Especially issues concerning translation of vital material has been very helpful. Furthermore, I would like to thank my sister who has been able to help me on technical issues in connection with spelling and layout of the thesis. Finally, I would like to express my thanks to Jens Borges who introduced me to this very interesting subject and has been very helpful during numerous aspects of the thesis.

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1. Introduction

"Nordea was affected by the financial crisis, but less than many other banks"

Christian Clausen, CEO of Nordea AB

During the last years there have been huge amounts of write-downs in the financial sector, numerous bankruptcies, many government bailouts and only a few success stories. One of the banks that have been less affected by the economic meltdown in comparisons to other banks is Nordea. There is no doubt that Nordea has been affected by the economic meltdown, nevertheless the bank has been able to build a stable foundation and thereby proactively put a limit on its loan losses. This has spread to all its subsidiaries, especially in countries such as the Baltic Sea region and Poland where the picture was similar. Where other banks have used all of their resources in overcoming this crisis Nordea has used much energy on strengthening its position on the local and global markets. Even though Nordea saw a radical increase in its loan losses the levels were very low compared to the sector in general. Furthermore, Nordea has been able to cope with the crisis in a manner that was not seen in many other banks, while incorporating its new strategic focus, which is already showing signs of success.

"We're very passionate about Poland. It's a good and well-run country, it has a large internal economy and it isn't so dependent on what is happening outside the country yet."

Thomas Neckmar, Head of New European Markets at Nordea AB

One of the most remarkable developments is that Nordea has been able to strategically focus more and more and the Eastern European markets. Given its strong capital base and its transparent banking model the bank has been able to massively expand its business within the Eastern European region. Nordea's core focus there has been on Poland. Being one of the great success stories from the former Soviet Bloc, Poland has escaped communism and the country is the only one in Europe that was able to avoid a recession during the financial crisis. The economy currently seems as one of the stronger ones in Europe and the long-term outlook for the country looks very solid[1].

Nordea has been opening up to 200 new branches over the last three years in Poland. During 2010 the bank opened 45 new branches and an operations centre in Poland and the bank expects to employ at least 500 additional workers during the next years[2]. Not only has this given the bank access to new customers in terms of households and corporate clients, but it has also given it access to new markets, that are expected to grow significantly during the next decade. The aim of this strategy is to be constantly growing organically by more than 30% on a year to year basis[3]. Furthermore, the bank desires to become a so-called "universal bank" and become among the five largest banks in Poland[4]. Currently, Nordea has a market share in Poland of 2,5%, measured in terms of total assets, and the banks needs to increase its asset base with 2,5 times to reach the desired goal[5].

Nordea has during recent years quickly increased its workforce as well as its shares of lending in Poland. In the same time however, Nordea has been forced to take huge write-downs on loan losses following a slowdown in economic growth in Poland and it seems the bank might be less profitable than first expected. It will be interesting to see how Nordea will manage the slow-down in the economy, and whether the bank is able to gain from the strong capital base and its strong banking model.

The aim of this thesis is to determine the share value of Nordea AB's subsidiary in Poland Nordea Bank Polska S.A. This will be done by using an equity cash flow model which will be forecasting future expected cash flows to equity holders. The valuation will differ slightly to the

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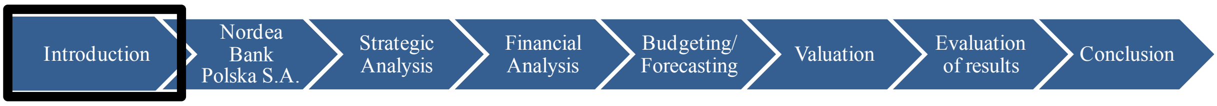
[1] New York Times (2010)
[2] Nordea AB Annual Report 2010
[3] Bendtsen, Simon. "Nordea varsler polsk storvækst"
[4] Kicinski, Wlodzimierz. "CEO letter 2009"
[5] Heering, Anders. "Nordea runder 200 filialer i Polen"

models observed in theory, since it will include a calculation of future expected capital requirements that the bank will be subject to. These will be done with a focus on the Basel III rules that were introduced during the middle of 2010.



1.1 Objective and Research Question

The objective of this thesis is to perform a financial valuation of Nordea Bank Polska S.A., using a modified equity cash flow model. The valuation will be done on Nordea's subsidiary in Poland and focus will be on the banks strategy and future expected performance in Poland. The valuation date will be the 31st of December 2010.

The thesis will aim at answering the following questions:

- What is the current theoretical share price of Nordea Bank Polska S.A.?
- Is the current price in the market under/over valued compared to the theoretical price?

In order to achieve this the thesis will:

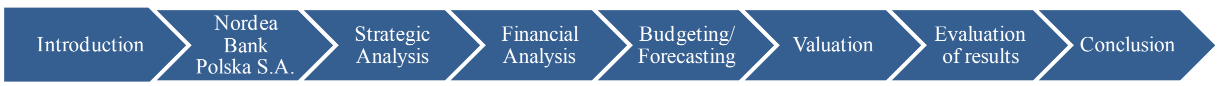
1. Identify the most appropriate valuation model for valuating financial institutions
2. Give an introduction to Nordea Bank Polska S.A.
3. Analyse the current macro environment the bank operates in
4. Perform a strategic and financial analysis of the bank
5. Budget/Forecast the future growth and income of the bank
6. Perform the valuation
7. Evaluate the findings in comparison to its peer group

1.2 Motivation

The objective of this thesis has been chosen for several reasons. First of all, the case of Nordea in Poland was considered to be very interesting following the rapid development the bank has experienced in the country in the recent years. Additionally, it was found interesting because it made it possible to explore a company and a country that was only affected by the financial downturn to a minor degree. The decision to analyse and valuate the subsidiary Nordea Bank Polska S.A. alone (and not the whole Nordea group) was made due to the nature and scope of this thesis, as well as to limit the project in terms of size. By limiting the thesis to one country it has been possible to perform an in-depth analysis of the macro and micro environment that the bank operates in making the results more precise and easier to interpret. Analysing the whole Nordea group would require an extraordinary amount of size (measured in number of pages), since one would have to valuate the bank using a sum of the parts valuation, where all its different markets would need to be treated separately. Furthermore, the subject was found to be of great relevance for someone who has an everyday contact to the financial world. Lastly, the subject made it possible to apply relevant theoretical frameworks and practices to a real life case, which is very appropriate for someone who is about to finalise his financial degree.

1.3 Structure and Methodology

The overall structure of the thesis is illustrated with the figure below.



Source: Own creation

In the introduction part the topic of the thesis will be introduced, the literature influencing the topic will be reviewed and the model used in the valuation will be presented. In the next section Nordea Bank Polska S.A. will be introduced to get an understanding of the banks scale of business in Poland. Throughout the thesis the mother company Nordea AB will be referred to as Nordea AB and Nordea Bank Polska S.A. will simply be referred to as Nordea Poland. In the strategic analysis the banks current strategic position in the country will be analysed. Models such as a PEST analysis and Porter's Five Forces will be used to analyse the external factors (the macro environment) of importance to the bank. Models such as a SWOT and BCG matrix will analyse Nordea Poland's current position seen from an internal perspective. In the financial analysis key historical performance indicators will be studied to get insights into the banks current financial state as well an overview of what drives the income of the bank. In the budgeting/forecasting part the key figures used in the valuation will be estimated using key insights gained from the strategic and financial analysis. In the valuation part the calculation of Nordea Poland's stock price will be carried out by using the model introduced in the methodology section. The next section will evaluate the results from the valuation by comparing the calculated price with the current market price as well as by carrying out a sensitivity analysis. Furthermore a relative valuation will be done to compare Nordea's price to some of its main competitors. The last section will conclude the thesis by answering the research questions outlined above.

1.3.1 Limitations

Some limitations are to be observed throughout the thesis.

First, through the review of existing valuation models as well as in the decision process of choosing the appropriate valuation model, the residual income valuation approach was only touched upon briefly. This was done since the model was found inappropriate due to the nature of how Nordea operates its business in Poland. The reasons for this are (among others) the limited payout ratio that the bank has as well as the model's inability to include capital requirement calculations when performing the final valuation.

Next, there were several limitations following the inconsistency of the annual reports that were available. First, some of the peer groups' annual reports of 2010 have not yet been published entailing some inconsistency when comparing Nordea Poland to some of the peer companies. Furthermore, given the fact that Nordea Poland only recently has published its annual report, some of the figures might be inaccurate and thus subject to updates. In addition, Nordea Poland's report on capital adequacy and risk management for 2010 has not yet been published, subsequently some of the figures have been calculated using the annual report and are therefore also subject to some degree of inconstancy. Lastly, given the fact that the public available information is very limited and in some cases only published in the local language some calculations may be subject some degree of deviation. Nevertheless, all the above inconsistencies are found to have a limited impact and are thus of minor relevance for the final outcome.

Another limitation of this thesis is connected to the fact that Nordea Poland is subsidiary of Nordea AB and therefore in some cases would not behave as a regular public company where the main goal is to create long-term shareholder value. However, given the banks current scope of operations and the manner in which it behaves, this has found to have a limited effect on the valuation carried out.

1.3.2 Research Methods

Data in this thesis has been collected and exploited in number of ways.

For data concerning Nordea Poland most data has been accessed through annual reports (of the mother company and the bank in Poland), other company published material, research reports, market reports as well as articles from newspapers and the internet. Material published directly by Nordea Poland can be expected to show some bias and thus must be used with carefulness.

For data concerning the bank's operational environment, sources such as country reports, industry reports, articles, market reports as well as official sources (like for example OECD and NBP) have been found relevant and therefore included in the thesis. These sources are considered to have a limited bias and should be interpreted in the manner they have been published.

Theories, concepts and calculation methods have been gathered from textbooks and theoretical articles.

The currency used throughout this thesis is Polish Zloty (PLN) unless otherwise stated. The analysis of Nordea Poland will include annual reports for the years 2005-2010 and for the peer group the same period is used, unless data for the year 2010 has not yet been published. Data not yet published will be marked n/a (not available).

Data has been collected up until (and including) Thursday the 17th of February 2011. This has made it possible to include information from Nordea Poland's Annual Report of 2010 as well as from one for the peer banks. Data published after this date will not be included in the thesis.

1.4 Literature Review

According to the theory of valuation, the value of an asset depends largely on the future benefits it will pay to its owner[6]. This than furthermore depends on the estimated future benefits of the future cash flow of the asset as well as the required rate of return. Any given asset, financial, physical or intellectual is said to hold some sort of value. The key to an optimal valuation is not only getting to the final value, but more importantly how one gets there. There has throughout history been an ever-increasing need for financial valuation services and there most likely will be the same in the future. Frameworks for business valuation are numerous and selecting an appropriate model is not complex per se, rather the task of translating complex financial issues from practise might prove difficult[7].

1.4.1 Valuation models

When performing an accurate and precise valuation it is crucial to select and use the most suitable valuation model. However, when deciding on such a model there a certain factors one must take into account. Many researchers have been debating this issue for decades and there are several ways to circumvent this (see appendix 1 for an example of this by Thomas Plenborg)[8].

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[6] Hitchner, James R. "Financial Valuation: Applications and Models"
[7] Pratt, Shannon P. "Valuing A Business: The Analysis and Appraisal of Closely Held Companies"
[8] Plenborg, Thomas. "Valg af (ideel) værdiansættelsesmodel"

Analysts use a wide range of valuation models. In literature there are also many types of models, but, even though the models differ from time to time, the underlying principles and assumptions of the model are identical. In literature there is a general tendency towards categorising the models into four valuation methods. These include discounted cash flow models, residual income models, asset approaches and market orientated approaches. Aswath Damodaran (2002) uses three core models. These are the discounted cash flow model, the relative valuation model and the contingent claim model (for a detailed description of these please see appendix 2).

1.4.2 Valuating Financial Institutions

Valuating financial institutions is somewhat different from valuating industrial corporations. First of all, analysts in many situations lack much critical information about the financial institutions (like for instance the capital structure or the funding sources) and therefore they have to rely heavily on judgments and estimates. Furthermore, since financial institutions are highly leveraged, valuations can be very sensitive towards small changes in key drivers of the valuation model. In literature there is a general agreement that when valuating financial institutions one should either use the discounted cash flow model or the economic value added model (EVA including the RI model which is a derivation of the EVA)[9]. Given the objective of this thesis the discounted cash flow model has been found the most appropriate to use in the valuation of Nordea Poland. When using the discounted cash flow approach in valuating banks one should use the equity discounted cash flow approach[10]. There are several reasons for this.

One of the key reasons is the fact that when valuating industrial companies using the standard discounted cash flow model, one separates the operating decisions from the financing decisions (i.e. separating the income statement and the balance sheet). However, when it comes to financial institutions these decisions are very difficult to separate since financing decisions compromises a great part of a financial institutions value chain. First of all, financial institutions use their balance sheet a lot more actively than industrial companies. Second, financial institutions generate a great degree of earnings from the manner in which they finance their assets. Third, financial

[9] Plenborg, Thomas. ”Valg af (ideel) værdiansættelsesmodel”
[10] Gross, Stephanie. “Banks and Shareholder Value”

institutions engage greatly in market risk taking on both sides of their balance sheet, whereas industrial institutions see risk as a side effect of original business activities. Thus, when valuating financial institutions it is important that items from the balance sheet are included in the cash flow[11].

Another key reason is the fact that it is hard to assign the right cost of capital (WACC) when using the standard discounted cash flow model to value financial institutions. This is due to the fact that debt in financial institutions is compromised from a variety of debt tranches with different maturities and different interest rates. Following this financial institutions very often have an asset-liability mismatch measured in terms of maturities. Furthermore, it is hard to estimate a constant future interest rate spread (the difference between interests received from the loans given and the interests paid to deposits). Lastly, small errors in calculating the WACC can lead to significant variations in the equity value since the margin of net interest income and cost of equity is very limited[12].

Finally, it is hard to measure the reinvestment rate of financial institutions by not taking the balance sheet into account. Financial institutions are regulated and need to meet certain capital requirements in order to carry out daily banking operations. In case financial institutions want to expand or grow, they need to reinvest (equity) capital and are therefore limited in the amount that can paid out to shareholders. It is therefore crucial that the reinvestment rates of financial institutions are included in the cash flow calculations[13].

There are several other reasons for favouring the equity discounted cash flow model when valuating financial institutions. First, the capital structure of a financial institution is very dynamic and therefore it is hard to estimate and use a constant debt ratio. Financial institutions constantly increase or decrease their level of loans and deposits, making is almost impossible to

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[11] Gross, Stephanie. "Banks and Shareholder Value"
[12] Gross, Stephanie. "Banks and Shareholder Value"
[13] Gross, Stephanie. "Banks and Shareholder Value"

estimate a constant level of debt. Second, the role of liquidity plays a very important role for banks. Looking at industrial companies the liquidity is only a residual of the production process, however in financial institutions the liquidity is the central role of the banking business making the future cash flows more volatile.

From these issues discussed above it is clear that when performing a valuation on a financial institution the best model to use is the equity discounted cash flow model. Furthermore, the model was found to be best suitable when including a calculation of capital requirement.

1.4.3 Model choice

The model that has been found to be the most appropriate to use as a starting point in this thesis is the equity discounted cash flow model that has been formulated by Koller, Goedhart & Wessels[14]. However, since this model does not include specific calculations of capital requirements that financial institutions are subject to the model will be modified slightly. The modified model will be presented after the introduction of the core model.

As a starting point the sum of the discounted equity cash flows of the years before the perpetual are found. This is done by using the following formula:

$$V_e = \sum_{t=1}^{\infty} \frac{CFE_t}{(1 + K_e)^t}$$

To start of with, all the individual cash flows in the specific periods t until perpetual are found. Cash flows can be determined in two manners using either a direct or an indirect approach. The theoretical correct approach is to use the direct approach where one subtracts cash-in and cash outflows. This approach, however is not relevant for banks since these rarely plan according to cash flows but tend to use economic performance measures. The more sufficient method in estimating cash flow is the indirect method, which is also the method used generally in practice.

[14] Koller, Tim & Goedhart, Marc & Wessels, David. "Valuation: Measuring and Managing the Value of Companies"

Using this method one adjusts the net income to derive at the future cash flow and the cash flow is defined using the income statement and balance sheet[15]. In this thesis future cash flows are estimated using the income statement and the income statement is estimated using aspects from the balance sheet. The final cash flows are found by subtracting the changes in the book value of equity from the sum of net income and other comprehensive incomes.

The equity cash flows in all the periods *t* are calculated using the formula:

$$CFE_t = NI_t - \Delta E_t + OCI_t$$

NI_t is the net income in the period *t*,

ΔE_t is the change in book value of equity in period *t*,

OCI_t is the other comprehensive income in the period *t*,

Following this the equity cash flows are discounted at the cost of equity. The cost of equity is calculated using the formula:

$$K_e = r_f + \left[E(r_m) - r_f\right] \times \beta$$

Where r_f is the risk-free rate of return,

$E(r_m)$ is the expected rate of return from the market,

$\left[E(r_m) - r_f\right]$ is the market risk premium,

β is the systematic risk of the equity.

After having found the sum of all the cash flows discounted at the cost of equity the continuing value is found. The continuing value is also discounted the cost of equity. The continuing value is found using the following formula:

[15] Copeland, Tom & Koller, Tim & Murrin, Jack. "Valuation: Measuring and Managing the Value of Companies"

$$CV = \frac{\mathrm{NI}_{t+1}\,(1 - \frac{g}{ROE})}{(K_e - g)}$$

Where NI_{t+1} is the net income in t+1 (calculated using NI_t x (1+g))

ROE is the expected long term return on equity,

g is the long term growth rate.

To find the final equity value per share the sum of all the discounted cash flows plus the discounted continuing value is divided by the total number of outstanding shares.

As mentioned earlier this model is found to be the most theoretical accurate model to use when valuating financial institutions. However, this model does not directly include the fact that financial institutions have to meet certain capital requirements. Given the fact that capital requirements play a large role in today's financial sector, it is the aim of this thesis to include a calculation of these requirements when having to perform the valuation.

The calculation will be done by including the capital requirement to the calculation of every cash flow and to the continuing value that are calculated to reach the final valuation. The equity cash flows are therefore calculated as:

$$CFE_t = NI_t - (\Delta CR_t + \Delta E_t) + OCI_t$$

Where $\Delta CR_t = (TCR_{t+1} + CB_{t+1}) - (TCR_t + CB_t)$

TCR_t is the total capital required at period *t*,

CB_t is the capital conservation buffer required at period *t*.

The continuing value will be calculated using the formula:

$$CV = \frac{(NI_{t+1} - \Delta CR_{t+1}) \text{ x } \frac{g}{ROE})}{(K_e - g)}$$

Where ΔCR_{t+1} is estimated using the total capital requirement in period t=10 and the long-term growth rate.

The capital requirements used in this thesis will be based on the new Basel III rules (see appendix 3 for an overview of these). Since the new rules will be phased in over a time horizon of 10 years the total capital requirement calculations will differ from year to year. Furthermore, it should be noted that the capital requirements calculations will only be done by including the minimum capital requirement and the capital conservation buffer. This is done due to the nature of which Nordea Poland operates in Poland, where most of its capital increase comes from either new share capital and/or retained earnings and thus are considered common equity (and/or Tier 1 capital). Furthermore, the countercyclical capital buffer has been left out due to missing information and implementation from the national authorities on this matter.

To evaluate on the valuation of Nordea Poland the theoretical share price will be compared to the current price. Furthermore, the calculated share price will be used in a relative valuation to compare Nordea Poland to some of its main competitors. The relative valuations will include a calculation of the P/E ratio and the P/B ratio.

The price to earnings ratio (P/E) is an illustration of how much investors are willing to pay for the earnings of a company[16]. The price to earning is found using the formula:

[16] Dermine, Jean. "Valuation and Value-Based Management"

$$\frac{\mathrm{P}}{\mathrm{E}} = \frac{\text{Current price of the share}}{\text{Total earnings per share}}$$

The price to book ratio (P/B) compares a company's current stock market value to its book value and an indication of how much investors are willing to pay for the book value of the company[17]. To find the P/B ratio the following formula is used:

$$\frac{\mathrm{P}}{\mathrm{B}} = \frac{\text{Total shareholders equity} - \text{Preferred Equity}}{\text{Total outstanding shares}}$$

To conclude the valuation a sensitivity analysis will be carried out to show how much the calculated share price will change when key factors used in the valuation are stress tested. At the end a recommendation of the share will be given.

[17] Dermine, Jean. "Valuation and Value-Based Management"

2. Nordea Poland

2.1 Nordea at a Glance

Nordea Poland is a subsidiary of Nordea AB. Nordea AB is a financial service institution operating in Northern European and in the Baltic Sea region headquartered in Stockholm in Sweden. It offers financial products to customers in retail banking, to corporate and institutional clients and investors. It has more than 1.400 branches and is currently serving 10 million private and close to 700 thousand corporate customers world-wide. Nordea AB also operates the world's largest Internet bank with around 5 million "log-ons" on a monthly basis[18].

2.2 History

The name Nordea first appeared in Poland in 2001, the year that the Nordea group was formed (for a history of the group please sees appendix 4). However, Nordea started operating in Poland a few years prior to this. In 1999 Nordea (back then known as MeritaNordbanken) acquired Bank Komunalny S.A. a bank located in Gdynia. This bank started operating already back in September 1992. Already from the beginning Bank Komunalny S.A. evolved and grew rapidly and by 1996 is was registered at the Warsaw stock exchange. However, the bank evolved even furthermore and after a few years it started to look for new investors. As a result Bank Komunalny S.A was acquired by MeritaNordbanken in 1999.

In the years following this acquisition Nordea Poland increased its network and its appearance in Poland considerably. In 2001 Nordea Poland merged with BWP-Unibank S.A. and extended its

[18] Business Wire "Nordea Has 2 Million Net-Banking Customers, Goal is Now Set to 2.7 Million"

sales network (this merger was a result of the overall merger between Unibank and MeritaNordbanken). In 2002 Nordea Poland acquired LG Petro Bank, substantially increasing the banks presence in Poland. This acquisition was not finalised and implemented before the following year. The final merger was carried out in 2005, where Nordea Poland acquired Sampo Group's life insurance in Poland.

Today Nordea Poland operates over 200 branches serving more than 590.000 households and 65.000 corporate customers throughout Poland[19].

2.3 Organisational Structure

In Poland Nordea is represented by 4 companies (for a detailed organisational chart see appendix 5)[20]. These include Nordea Bank Polska S.A., Nordea Życie S.A. (Nordea Poland Life Insurance), Nordea PTE S.A. (Nordea Open Pension Fund) and Nordea Finance Polska S.A (a leasing company). Only Nordea Bank Polska S.A. operates as a single legal entity. The remaining three companies operate under Nordea Life Holding AB. Nordea Poland's headquarter in the country is located in Gdynia and the bank currently employs 2.200 employees (1.949 in 2009) and is expected to increase its work force in the country with up to 500 new employees in the coming years [21].

2.4 Ownership Structure

Nordea Poland is a public company and is registered on the Warsaw stock exchange in Poland. Most of the shares (99,21%) are however directly owned of Nordea AB since this is the strategic mother company of the bank[22]. It must though be mentioned, that the company still has a limited amount of free floating shares, which are traded on a regular basis. At the end of 2010 Nordea

[19] Nordea AB Annual Report 2010 & Nordea.pl
[20] Nordea AB Annual Report 2010
[21] Nordea AB Annual Report 2010
[22] Nordea Poland Annual Report 2010

Poland had a total amount of approximately 55,5 million shares outstanding with a total number of 2 registered main shareholders in Sweden and Poland[23].

The shares are denominated in Zloty and carry a nominal value of 5 PLN. All shares in Nordea Poland carry one voting right at the Annual General Meetings. The last time Nordea Poland paid out dividends was on the 11th of august 2006 where an amount of 1,86 PLN was paid out in form of a regular cash dividend[24]. Nordea Poland has during the last 3 years issued a total 21.880.867 of new shares resulting in a total share capital of approximately 277,5 as of the end of 2010[25].

2.5 Products

Targeting its clients in Poland the aim of Nordea Poland is to offer the same products as the whole group (Nordea AB) offers to clients in its other regions. These include a range of different products and financial services dependent on different markets and segments. Nordea AB's product range includes account products, transaction products, financing products, capital market products, savings & assets management products and life & pension products (for a detailed description of the products see appendix 6).

In Poland, Nordea Poland primarily offers products from its account product segment and the bank targets individuals and corporate clients. Furthermore, Nordea Poland offers a very limited amount of asset management products as well as life insurance products (these products are offered through its other companies in Poland).

2.6 Mission, Vision and Values: The Nordea Way

Nordea Poland has ambitions of becoming a large, well-known and acknowledged bank in Poland. By transferring the mission, vision and corporate values from its mother company

[23] Bloomberg
[24] Bloomberg
[25] Nordea Poland Annual Report 2010

Nordea Poland wants to create long-term values to its share- and stakeholders in Poland. The Nordea group operates by using a two dimensional strategy with focusing on is operational strategy and financial targets. The banks strategic target goals is divided in 3 components[26]:

- Growth strategy:
  Nordea AB's target is to pursue a growth strategy in order to generate sufficient income and resources to ensure great customer experience and thus creating long-term value.

- Best relationship bank:
  Nordea AB wants to be a great relationship bank in order to retain current customers and attract new customers.

- One operating model:
  Nordea AB wants to create a simple operating model for all its activities to free up resources and to create transparency as well as being able to offer better services to customers.

Several years ago Nordea AB initiated this strategy in order to evolve "from a good bank to a great bank". This focus has hereafter been transferred to all its subsidiaries including Nordea Poland. The strategy is known under the term "prudent growth" and the road to fulfilling this is reached by carefully balancing risks and opportunities.

2.7 Competitors

Given Nordea Poland's current size (measured in market shares of assets) it can be argued that Nordea Poland has a range of competitors throughout Poland, especially given the fact that the number of banks in Poland is constantly increasing[27]. Nevertheless, given the banks strategy and its main goal of becoming among the top five banks in Poland[28] Nordea Poland must be

[26] Nordea AB Annual Report 2010
[27] The Economist Intelligence Unit. "Industry Report: Financial Services"
[28] Bendtsen, Simon. "Nordea varsler polsk storvækst"

considered to have the top banks in country as their major competitors. Given the bank,s current scope, size and operations together with the future potential and targets its main competitors are found to be (these will be Nordea Poland's peers going through the thesis)[29]:

- PKO Bank Polski S.A.[30]

  The bank is considered the largest and oldest bank in Poland. It is a public company, but the majority of shares are owned by the state (approx. 41%).

- Bank Pekao S.A.[31]

  The bank is part of the Italian UniCredit group. It is considered among the largest banks throughout Central and Eastern Europe. The bank is a public company but largely owned by UniCredit (approx. 59%).

- BRE Bank S.A.[32]

  The bank is considered among the largest with respect to providing financing to corporations and state agencies in Poland. It is a public company and has formed a strategic alliance with Commerzbank AG making them the largest shareholder (approx. 70%).

- ING Bank Śląski S.A.[33]

  The bank offers commercial banking services to corporate clients and individuals. The bank is a public company with ING Bank as its main and strategic shareholder (approx. 75%)

- Bank Zachodni WBK S.A.[34]

  The bank offers a range of banking services to individuals and primarily small and medium sized (SME) companies. The bank is a public company with Allied Irish Banks as their main strategic shareholder (approx. 70%)

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[29] The Economist Intelligence Unit. "Industry Report: Financial Services"
[30] Pkobp.pl
[31] Pekao.com/pl
[32] Brebank.pl
[33] Ingbank.pl
[34] Bzwbk.pl

3. Strategic Analysis

To get an overview of the factors influencing Nordea Poland a strategic analysis will be performed. First of all, issues that can have an effect on Nordea Poland seen from a macro environment perspective will be analysed. Next an analysis of the Polish banking sector will be made to identify the potential competition that Nordea Poland is faced with. Lastly, an internal company analysis will be made to identify the potential strengths and weaknesses, that Nordea Poland currently is facing and thus will be facing going forward.

3.1 Macro environment

As an introduction to the subject a brief history of Poland and the country's financial sector will be given. To identify the macro economical factors a PEST analysis will be performed. Here the individual factors will be analysed separately to get an in depth understanding of how these factors have a potential influence on Nordea Poland.

3.1.1 History

Being one of the main countries located in the Central European region (CEE) Poland is considered to be among the healthiest of all countries in the region. Furthermore, Poland is the only member of the European Union that was able to avoid a recession during the financial crisis and is currently one of the fastest growing within the region[35]. As a former socialist country Poland has been suffering from slumps in social and economical standards, high unemployment and limited human rights. However during the early 1990's by the initiation of Lasek Balcerowicz (Finance Minister of Poland from 1989-1991) the country was able to transform

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[35] The Economist Intelligence Unit. "Country Report: Poland"

from a socialist planned economy into a market based economy. Following this, Poland saw the economy boom and was able to report high growth rates in GDP as well as several improvements with respect to its working conditions, market conditions and human rights. Poland joined the EU during 2003 and attained full membership during the following years. Additionally, Poland became part of the Schengen agreement in 2007 and the borders of EU were moved further East, where Poland's borders was seen as being the eastern borders of the EU. This transformation also had its impact on the banking sector[36].

Before 1989 most banks in Poland were state-owned and the competition among those was very limited. In the year 1989 most banks were owned by a co-operative, but with the collapse of the communism banks underwent privatisation and most banks became privately owned. The total number of banks was also reduced dramatically during these years. The development of the Polish banking sector starting from the 1980's can be divided into 3 stages[37]. The first stage (1989-1992) was characterised by the increase in competitive pressures where banks transformed from publicly-owned to privately-owned. During this phase the banking sector was still lacking a sound legal and regulatory foundation. The second stage (1992-1997) was characterised by a total restructuring of the sector following a more competitive environment that was caused by the introduction of new legal reforms. The third stage (1998-) was characterised by an increase in strategic investors, who took advantage of the rapidly growing sector. This is also illustrated with the immense increase in foreign banks and investors. Most banks in Poland today (around 75%) are either of foreign origin or owned by international investors, where most of these are from Germany, Austria or Holland. As a result the sector has become more westernised and it has seen a dramatic increase in the level of competition[38].

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[36] The Economist Intelligence Unit. "Country Report: Poland"
[37] Figueira, Catarina & Nellis, Joseph G. & Parker, David. "Challenges Facing the Polish Banking Industry"
[38] The Economist Intelligence Unit. "Country Report: Poland"

3.1.2 PEST analysis

To analyse the external macro environment in which Nordea Poland operates in the PEST-model will be used. PEST is an acronym for the following factors:

- Political factors
- Economic factors
- Social factors
- Technological factors

3.1.2.1 Political factors

The political system in Poland is currently very unstable following the plane crash near Smolensk in Russia last year. Currently Poland is governed by the centre-right Civil Platform (PO) in coalition with rural-based Polish Peasants Party (PSL). The ruling parties are currently facing strong opposition from the Conservative Law and Justice party (PiS). Adding to this, comes the fact that there are several risks of disputes between the parties especially following the alleged lobbying scandal that broke out in 2009[39]. It is however expected that the current government will remain the governing party after the election this year, which in turn will make the political environment more calm and stable.

As touched upon above Poland has recently transformed into market-based economy that is characterised as being more open and free, compared to how it was previously. In connection to this Poland has only recently changed into a democracy, but is already at the current state showing great signs of transformation. Especially areas such increased participation in globalisation of production and finance and the increased foreign direct investments (FDI) associated with the openness towards the west have influenced the country massively. Poland's joining of the EU has only supported these developments[40]. However, there are also certain obvious dark sides in respect to the economy in Poland. These among others include inefficient-

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[39] The Economist Intelligence Unit. "Country Report: Poland"
[40] The Economist Intelligence Unit. "Country Report: Poland"

government, bureaucracy, the lack of transparent tax regulations and a high level of corruption[41]. Whether the upcoming election will have an influence on these can only be questioned.

During the last decades there has been a range of political responses carried out in order to respond to the economical crisis in Poland. The decision to focus on using effective inflation targets (currently at 2,5%[42]) and a floating exchange rate has build strong confidence into the Polish economy. Furthermore, a focus on using structural policies has improved the county's labour market participation and privatisation[43]. It is the plan according to the Polish finance minister that Poland at some point will join the European Exchange Rate Mechanism (ERM II) and the Euro. However, given the current fluctuations of the Zloty and the fact that Poland has not yet fulfilled the requirements of joining the Euro this is not expected to happen in the short term[44].

There have also been several policy implementations in response to the crisis. First, the Polish economy was stimulated from fiscal policies involving tax cuts that were carried out in 2006/2007 (with effect in 2009) and the usage of automatic stabilisers. These caused a mitigation of the growth slowdown but however caused an increase in the government deficit. Markets in Poland have reacted rather positively to this especially following the fact the country has entered (and recently extended) into an agreement with IMF concerning a flexible credit line in times of economic slowdowns. Furthermore, the economy has been stimulated using monetary policy interaction[45]. Due to falling inflationary pressures Poland took a loosening stance regarding its monetary decision and cut its leading interest rate to a record low of 3% in 2009. It is not until recently, that Poland has increased the interest rate by 25 bp due to increased inflationary pressures and a weakening of the Zloty[46].

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41 OECD. "Economic Surveys: Poland"
42 NBP.pl
43 IMF. "Republic of Poland: Arrangement Under the Flexible Credit Line"
44 PMR Research. "Poland's Entry into the ERMII"
45 IMF. "Republic of Poland: Arrangement Under the Flexible Credit Line"
46 Rozlal, Monika. "Polish Central Bank Increase Main Interest Rate for First Time Since 2008"

3.1.2.2 Economical factors

When looking at the economical factors it can be argued that there most certainly are some factors that have a more direct effect on banks than others[47]. Thus, it is important to select the most appropriate ones. In this section factors such as GDP, Inflation, unemployment rate, housing market and consumer spending will be touched upon.

Gross Domestic Product

To start with and to get an overview of the performance in an economy it is optimal to start looking at Gross Domestic Product (GDP).

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP growth	3,6	6,2	6,8	5,0	1,8	3,8	3,4	3,7	3,4	3,6

Source: Economist Intelligence Unit

As can be observed above Poland has from 2005 until today reported relatively high growth rates in real GDP. Poland is the only EU member country that was able to avoid a recession during the last years[48]. Nevertheless, it also becomes evident that Poland was affected by the economic meltdown in recent years especially in 2009 where GDP growth fell from 5,0 to 1,8. This was the time where many countries found themselves in a recession or depression. The recent published GDP figure shows that Poland more than doubled its GDP in 2010 in comparison to 2009[49]. The reported figure was higher than expected by many analysts and is a clear sign that Poland is performing reasonably better than first anticipated.

When comparing Poland's figures to the GDP growth rates of its neighbouring country Germany and the average EU country, one observes that Poland has shown impressive economic performance during the last years. Where one of today's leading economies reported growth rates of close to -5% Poland was able to grow by a litter under 2%.

[47] Blanchard, Oliver. "Macroeconomics"
[48] OECD. "Economic Surveys: Poland"
[49] Rozlal, Monika. "Poland's Economic Growth Rate More Than Doubled in 2010"

Source: Economist Intelligence Unit

Overall it seems that the growth in 2008-2010 was driven by consumption, inventory rebuilding and net exports[50].

When looking a decade back in time there are several main reasons for the growth observed in Poland. First of all, after Poland joined the EU and the Schengen Agreement the borders of the country were opened and the country experienced a massive increase in FDI, especially sectors such as the financial sector and the industrial sector were influenced by this. Additionally the country experienced an increase inflow of workers and visitors which unquestionably had an effect on several industries[51]. Second, Poland has experienced increased investments in its infrastructure following an increased inflow and growth of especially infrastructural funds mostly originated from other EU countries as well as following support from the EU[52]. Heading towards the summer of 2012 where Poland is co-host of the European football championship, the country has been forced to make excessive investment into its infrastructure (for the construction of roads, highways, airports, bridges and railway). The financing of these investments comes from support of the EU and other external entities and only a very limited fraction of the financing comes from Poland[53]. Thirdly, a cut on income tax has had an effect (and will have) on private and public consumption. It is expected that the gross disposable income per capita will grow from a current very low level, and especially the service sector will experience the effects of this[54]. The growth in private consumptions was possible even though banks reported a sharp decline in

[50] Rozlal, Monika. "Poland's Economic Growth Rate More Than Doubled in 2010"
[51] OECD. "Economic Surveys: Poland"
[52] Cienski, Jan. "EU Funds Turn Poland Into €10bn Building Site"
[53] Cienski, Jan. "EU Funds Turn Poland Into €10bn Building Site"
[54] National Bank of Poland. "Inflation Report October 2010"

demand for consumer loans to privates simply due to the tax cuts carried out during 2006 and 2007. Lastly, the country has been able to maintain a decent level of foreign trade balance (in comparison to other Central and Eastern European countries) with countries such as Germany and China[55].

There are however also certain drawbacks in connection with the growth observed in Poland. One of the key issues resulting from the policy responses carried out to stimulate growth is the increase in public debt. Poland's budget deficit is currently well above the Maastricht threshold of 3% of GDP and is not expected to become in range of this for the next 3-5 years[56]. The government in Poland is forced to introduce measures to deal with this deficit but however, as long as the economy is still in the phase of a recovery this can be very hard. Generally there is slight frustration in the country directed towards the governments due to its lack of putting fourth a plan about how it intends to deal with the increasing deficit[57]. Another drawback is connected with the fact that even though the economy is in a recovery state many of its neighbour countries are not progressing as well and thus the country runs the risk of a *domino effect*. Especially Ukraine and Romania could have a negative impact on Poland[58].

Going forward the GDP in Poland is expected to be around the current level at 3,5-3,8% which in the short run is well above what the GDP levels are expected to be in countries such as Germany and the United States. This is as great advantage for Poland since this could attract increasing interests from abroad.

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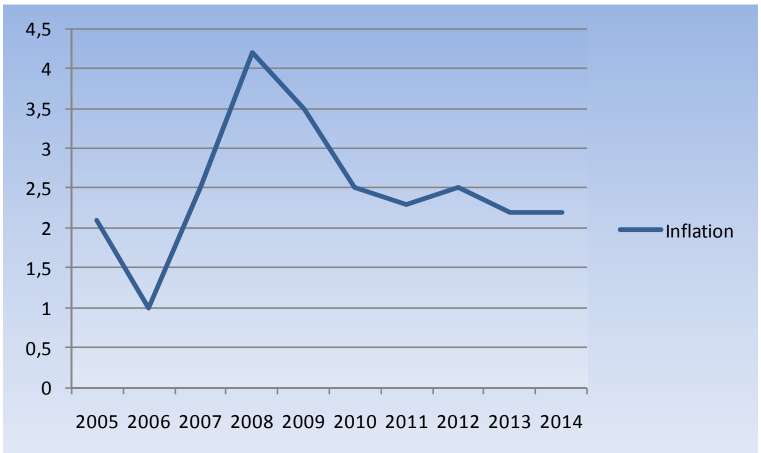
[55] Christensen, Lars. "Surprisingly Good – Outlook for the Central Eastern European Economies"
[56] The Economist Intelligence Unit. "Country Report: Poland"
[57] Rozlal, Monika. "Poland's Economic Growth Rate More Than Doubled in 2010"
[58] Christensen, Lars. "Surprisingly Good – Outlook for the Central Eastern European Economies"

Inflation

Headline inflation in Poland has been at an average level of 2,5% during the last five years and is reasonably higher in comparison to the EU average[59].



Source: National Bank of Poland

The sharp increase from 2006 to 2008 can to a great part be attributed to higher prices of food and non-alcoholic beverages as well as higher prices in connection with energy products. On the other hand the fall in inflation through 2008 to 2010 was caused by a strong fall in energy prices combined with the sharp depreciation of the Zloty. The development of energy prices can to a large degree be connected to the development of the prices in crude oil and the price of natural gas which both peaked during 2008. The development in food prices is mostly connected with the prices of agricultural and food commodities that have been observed through out the period.

Going forward inflation is expected to stay at a level between 2-2,5%[60]. This is due to the downward trend in the growth wages as it is expected that many Poles will be returning to work in the country. Additionally tighter monetary polices in terms of using inflation targets will have a disinflationary effect[61].

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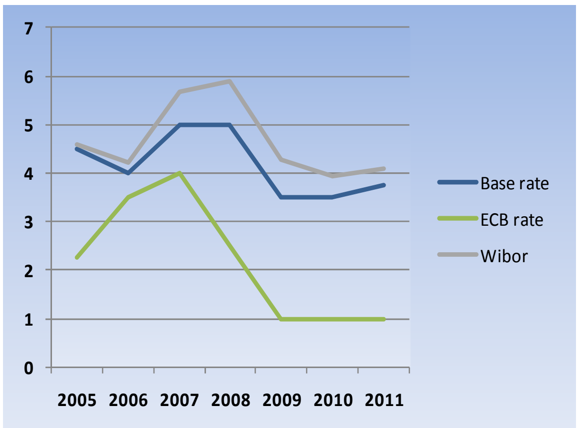
[59] National Bank of Poland. “Inflation Report October 2010"
[60] The Economist Intelligence Unit. “Industry Report: Financial Services”
[61] The Economist Intelligence Unit. “Country Report: Poland”

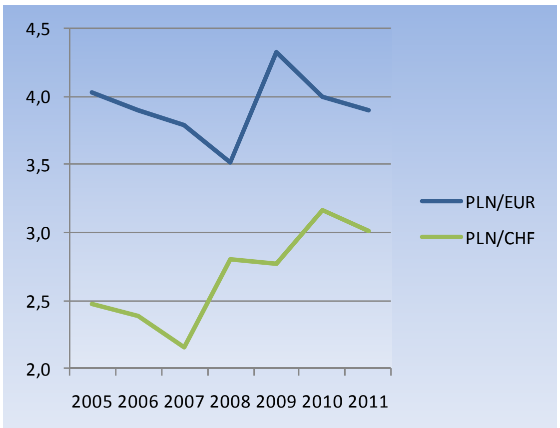
Inflation expectation is according to the central bank in Poland a major driver of inflation in the country and has been rather constant during the last 12 months[62]. In general it seems, that inflationary pressures are to be limited for the economy going forward. Minor concerns on this matter can be connected to the risks that domestic demand could recover more strongly than first anticipated as well the constant increase in oil and gas prices[63].

Fiscal and Monetary Stimulus

One of the ways of controlling inflation is by using fiscal stimulus or monetary policy interventions. A good example of this, is the recent national bank interest hike, that was seen in mid January 2010[64]. The interest rate hike was carried out to be sure that inflation stayed within its targets as well as that the Zloty did not weaken even further. This example shows the tools that Poland has to cope with high inflation and how the country can to stimulate growth during an economic slowdown. During the financial downturn most Central Eastern European countries (including Poland) could not afford fiscal stimulus (like the QE session seen in many countries), because of an already high level of budget deficits. These countries were forced to use monetary policy to work themselves out of the crisis[65]. This is also why the base rate and the money market rate in Poland, for the time being, are reasonably higher in comparison to the Euro-zone (see left graph below).



Source: National Bank of Poland & ECB



Source: Bloomberg

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[62] National Bank of Poland. "Inflation Report October 2010"
[63] National Bank of Poland. "Inflation Report October 2010"
[64] Rozlal, Monika. "Polish Central Bank Increase Main Interest Rate for First Time Since 2008"
[65] Christensen, Lars. "Surprisingly Good – Outlook for the Central Eastern European Economies"

Once the global economy slowed down Poland was able to stimulate growth by hiking interest rates and thus creating a weaker currency[66]. This is illustrated with the right graph above where the PLN devaluated massively against the EUR and the CHF. Most European countries could not use this mean of stimulating growth since they were part of the Euro and thus did not have the possibility to devaluate the currency.

Unemployment Rate

The unemployment rate in Poland has decreased reasonable during the last decade and has stabilised at the end of the period analysed. Starting from 16,2 % in 2001 up to nearly 20% in 2004 and steadily improving and stabilising at 10-11% in the last years[67].

The main reason to why Poland observed high unemployment rates in the beginning of the decade is related to the fact that the country has only recently undergone a political transformation and introduced new labour market regulation. Following this, the labour market in Poland has become reasonably more flexible and the average working age has increased[68]. One of the main reasons to why the unemployment rate has stabilised during the last years is because there has been a halt in the decline of employed in the industry and increase of employees in the service sector and to some degree in the construction industry[69]. Generally there has been an increase in economic activity among young people in Poland in the last years[70].

However, when having a limited growth in demand for labour and an increasing average working age of the individual worker one ultimately gets a higher unemployment rate. This is also what can be observed from the figures in 2008 to 2010. At the current state the labour market is missing good indicators, which generally are due to the lack of economic growth[71]. Furthermore

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[66] Bartyzel, Dorota. "Polish Interest-Rate Increase Didn't Start Policy Cycle, Kazmierczak Says",
[67] The Economist Intelligence Unit. "Country Report: Poland"
[68] National Bank of Poland. "Inflation Report October 2010"
[69] National Bank of Poland. "Inflation Report October 2010"
[70] National Bank of Poland. "Inflation Report October 2010"
[71] The Economist Intelligence Unit. "Country Report: Poland"

given the current level of unemployment relative to other EU countries the consumer confidence (an indication of optimism among consumers) is downward sloping and currently reasonably low[72].

Going forward it seems that Poland will have a downward sloping trend in unemployment where the unemployment rate will stabilise at around 10% for the coming years. Once the global economy picks up Poland will witness a positive trend in unemployment.

Housing Market

In recent years there has been a decline in housing prices in Poland. This can to some degree be connected to the tendencies seen throughout most of Europe where the situation has been similar. However, given the fact that the economy is showing signs of recovery one could easily draw the opposite conclusion. The largest decrease of net wealth connected to housing is mostly seen in the main cities Warsaw and Krakow but in other smaller cities the actual house prices have dropped between 22-30% from the top in 2008. One of the main reasons to the fall in housing prices is the current over supply of houses in Poland, which in turn could lead to a weaker construction sector for the coming years[73].

One of the major concerns regarding housing in Poland is the fact that many loans in respect to financing of housing are given in foreign currencies primarily CHF and EUR. Loans in foreign currencies are made to give customers an advantage in terms interest rates in the foreign currency. Given the fact that Poland uses a free-floating exchange rate makes these loans reasonably more risky, than the loans in the domestic currency. This is in great line with the famous interest rate parity where no arbitrage opportunity exists when borrowing or lending in foreign currencies due to exchange rate fluctuations. For instance, most foreign currency loans in Poland were given in CHF (70% in 2009 and 59% in 2010) and following the constant appreciation of the CHF and the depreciation of the Zloty these loans have grown rapidly in

[72] KBC Bank Market Research. “Central European Daily”
[73] Global Property Guide. “Polish House Prices Continue to Fall, Despite Economic Growth”, 2010

nominal terms and have caused a massive increase in the net debt of housing loans[74]. This makes many households and businesses technically insolvent and can lead into difficulties when having to pay of debt. Furthermore, this combined with the fact that the percentage of housing loans measured to total loans is constantly increasing, can furthermore give an increase in numbers of defaults seen on housing loans in Poland.

Consumer Spending

The last but not least important economical factor to look at is consumer spending. Consumer spending in Poland is one of the main drivers of the current recovery of the economy and thus can have a great impact going forward. During the recent years Polish consumer spending has been rising constantly despite pressures from many (western) countries to put a limit on spending to decrease the budget deficit[75]. The rise in consumer spending can be related to the tax cuts carried out in recent years as well as the increase in income per capita.

Domestic consumption has also had an effect on the steady rise of short-term borrowings as the use of credit cards in Poland has become increasingly popular. A good illustration of this tendency is the appearance of new banks that specialise in personal financing[76].

3.1.2.3 Social Factors

When turning to the social factors a good starting point is to look at the Human Development Index (HDI Index). The index is used to rank countries in terms of human development and ranks them as developed (very high and high), developing and underdeveloped. The index is a relative index and includes factors such life expectancy, level of education, mean and expected years of schooling combined with the level of income per capita[77].

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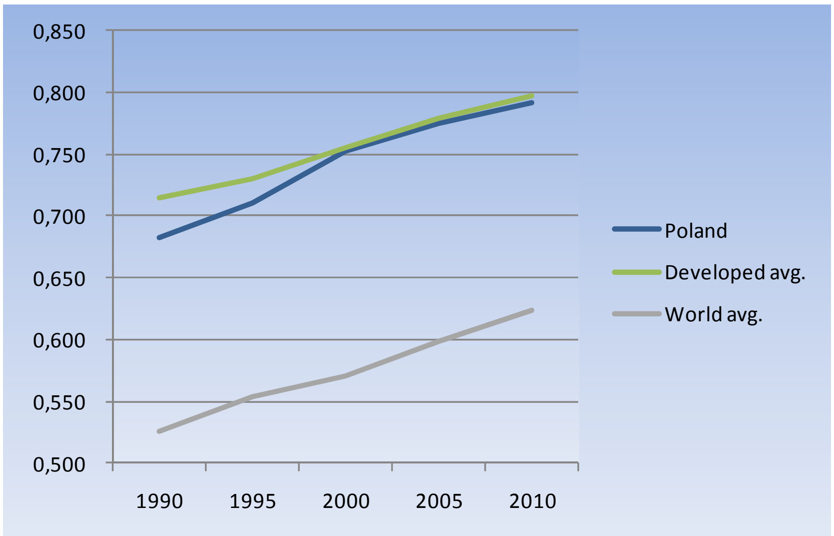
[74] The Economist Intelligence Unit. “Industry Report: Financial Services”
[75] Food & Drink Insight. “Consumer Spending To Continue Booming Despite Eurozone Austerity”
[76] The Economist Intelligence Unit. “Industry Report: Financial Services”
[77] Human Development Reports. “Human Development Report 2010”



Source: Human Development Report 2010

Poland's HDI Index has increased substantially during the last twenty years especially from the 1990s to the beginning of this century (see graph above). The index increase can greatly be connected to the fall of the communism and the transformation of the political system that caused massive changes in the labour market, and the approach of using a more market-based economy. Since then factors such as life expectancy and the level of education have increased fundamentally[78]. Looking at the index in comparison to an average of the developed countries it seems Poland still has a little way to go. This can however, be related to the fact that the country only recently changed its political system and thus is still in a phase of transformation. On the other hand, when comparing to the average world index it seems Poland are doing quite well.

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Population (m)	38,20	38,10	38,10	38,10	38,20	38,10	38,10	38,10	38,10	38,10
Households ('000)	13.582	13.650	13.715	13.766	13.825	13.883	13.942	14.001	14.060	14.120
Median Hosuehold income (PLN)	42,08	44,25	47,29	50,74	54,50	56,73	59,46	63,21	67,34	71,50

Source: Economist Intelligence Unit

Turning to some of the basic social factors the above table gives some good insights. First of all it seems the population in Poland has been rather stable and is expected be stable for coming years. However the number of households is expected to increase slightly. This can be linked to the fact that there has been a decline in newborns, increasing divorce rates etc[79]. The median household income has risen constantly during the last 5 years and is expected to continue rising going

[78] Human Development Reports. "Human Development Report 2010"
[79] PRS Group. "Country Report: Poland"

forward. The median household income normally falls with around 10% during an economic crisis and/or rescission, however in the case of Poland the median household income has not been affected to the same extent[80]. This is a clear indicator of how well Poland has been in overcoming the crisis.

There are two things that could be slightly worrying about Poland, when looking at the social factors. First, there is the high unemployment rate (relatively seen in comparison to other EU countries), which can have a negative effect on especially on income per capita and on the median household income. Furthermore, there has been an increasing concern in connection with the low level of spending on health care. Given Poland's demographic distribution, there is need for increasing health care in order to satisfy the living standards in the country[81].

3.1.2.4 Technological Factors

At the current state it is not likely that there will be any invention with those in line of the internet and the mobile phone. Nevertheless, the technology sector is constantly changing and this is also the case for Poland.

Poland is the largest communications market in central Europe and its largest spending lies within the information technology (IT) sector. Generally the sector has experienced a set back due to the economical crisis but is slowly recovering. The main area of competition lies within the mobile phone industry especially due to inadequacies with respect to fixed-line telecommunication services[82]. However there is room for improvement. During 2009 it was highlighted by the European Commission that Poland had severe problems in connection with its communication services[83].

[80] PRS Group. "Country Report: Poland"
[81] PRS Group. "Country Report: Poland"
[82] The Economist Intelligence Unit. "Telecoms and Technology"
[83] The Economist Intelligence Unit. "Telecoms and Technology"

The problems with the technological sector in Poland are twofold. First, the sector has been highly regulated in the past, which in turn has put limitations on spending made on research and development in the sector. Second, the sector has a severe shortage of workers within the industry, as many IT-professionals have moved overseas to higher paying jobs[84].

For a table summarising the main points of the PEST analysis please see appendix 7.

3.2 The Polish Banking Sector

The following section will be analysing the current state of the Polish banking sector. As a starting point a brief introduction to the financial sector in Poland will be given. Then the sector will be analysed using the Porters five forces approach to determine the competitive intensity and attractiveness of the sector.

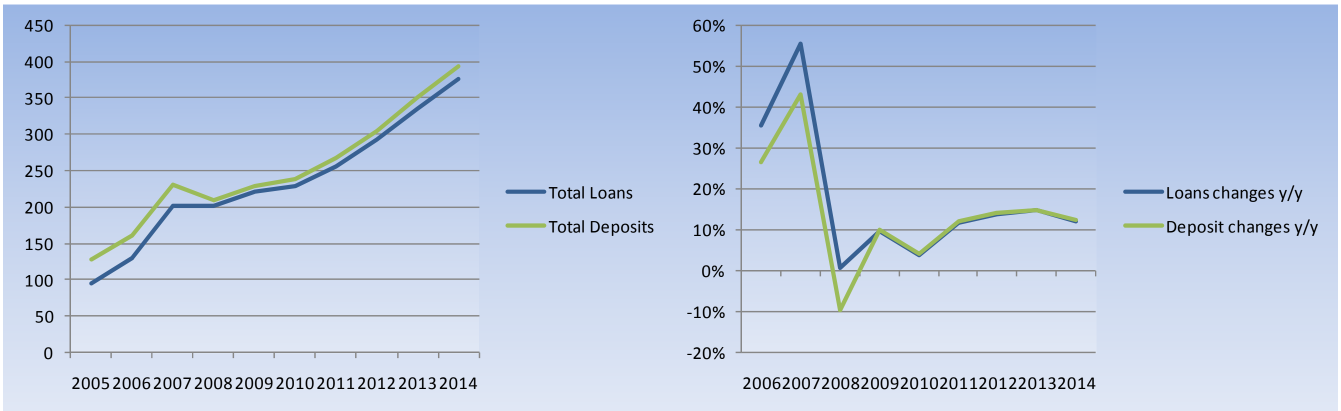
3.2.1 Banking in Poland

The financial sector in Poland accounts for 4% of Gross Value Added and close to 3% of total employment[85]. The sector has developed into a well working and well-regulated sector and it has gone through the financial downturn without any major problems. At the current state the sector is very fragile (as many other national banking sectors are) due to the European sovereign debt crisis[86]. Going forward the financial sector in Poland is expected to increase in terms of GDP however given the after effects of the financial crisis growth is expected to be lower than seen in the past years. Poland currently has secured financial support from the IMF and the World Bank, which would give the country the necessary support in case of a financial collapse.

Household demand for financial services in Poland has been, and still is, relatively limited even though many new services have been introduced recently. Banking in Poland is still very traditional and the customer still favours to be able to visit the banks branches, rather than

[84] The Economist Intelligence Unit. “Telecoms and Technology”
[85] The Economist Intelligence Unit. “Industry Report: Financial Services”
[86] The Economist Intelligence Unit. “Industry Report: Financial Services”

contacting the bank through the Internet or via the phone[87]. This makes it necessary for banks in Poland to have a high level of service as well a decent number of branches to be able to meet the demands of the customer.



Source: Economist Intelligence Unit

The demand for credit has been increasing in the past recent years (see figure on the left) where most borrowing has been in terms of housing financing and in terms of short-term borrowing following the increased usage of credit cards[88]. It is interesting to observe that the sector seems to have an overflow of deposits in comparison to credit and thus it seems the sector is well-funded.

Credit growth will definitely be limited in the coming years as it is illustrated in the right graph above. This (among others) can be connected with the new rules that were issued by PFSA in 2010 that forbids households with an income under a certain level to obtain credit. The positive issue concerning this, is the fact that it is more unlikely that bubbles in mortgage and consumer lending will arise. Other issues connected with the slowdown in credit growth could be related to the over-supply in the housing market, the general increased regulation and the fact that lending is becoming more expensive.

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[87] The Economist Intelligence Unit. "Industry Report: Financial Services"
[88] The Economist Intelligence Unit. "Industry Report: Financial Services"

3.2.2 Porter's Five Forces – The Polish Financial Sector

To analyse the financial sector that Nordea Poland operates in Porter's five forces framework will be used (see Appendix 8.1 for an illustration of the model). The idea behind this model is that the level of competition and attractiveness in the sector depends on several forces that form it. These forces arise from:

- Industry competitors
- Threats of new entrants (level of entry barriers)
- Threats from substitutes products or services
- Bargaining power of suppliers
- Bargaining power of buyers

3.2.2.1 Industry Competitors

When looking at competition in any given industry a good starting point is to look at market shares and the number of active players in the industry. Nordea Poland's market share (measured both in terms of lending and deposit) in Poland is relatively limited especially when comparing to the market shares the Nordea group has in Denmark and in the Baltic Sea region (see table below).

Market Shares in %	Lending			Deposit		Total number of banks	Herfindahl Index
	Corporate	Consumer	Mortgage	Corporate	Household	Absolut figures	(0-10.000)
Denmark	20%	18%	16%	23%	22%	164	1.042
Baltic Countries	14%	5%	13%	7%	5%	139	1.988
Poland	2%	1%	4%	2%	1%	710	574
Germany						1948	206
EU (Avg.)						310	632

Source: Own creation using European Central Bank. "EU Banking Structures"

When looking at the number of banks in the country it seems that Poland has a reasonably large number in comparison to the EU average. Interesting is the fact that Poland, considering its recent historical development, has approximately the same number of banks as France (712) does[89]. This is explained by the extreme high growth, continuous consolidation and the very high levels

[89] European Central Bank. "EU Banking Structures"

of foreign investments, that has characterised the sector during the last decade. In 2010 foreign banks accounted for 68% of total assets in the country[90]. Nordea Poland currently only has a very low fraction of its total operating income in Poland and this might by due to the high level of competition in the country[91].

A good way of measuring competition in a given industry is by using the Herfindahl Index[92]. This index measures the general size of firms relative to the size of the industry or country the firm is located in. The higher the index measure is the lower the level of competition. The average index measure within the European Union is 632. For Nordea AB the country with the highest Herfindahl Index and thus the highest level of competition is Poland. Given Nordea's current market share in Poland it seems there is room for growth, however given the fierce completion and the number of banks in the country it seems challenging for the bank to increase its market shares.

3.2.2.2 Threats of New Entrants – Entry Barriers

The pressure arising from the threats of entrants of new banks in Poland is twofold. First of all, banks when offering financial services (lending activities) are forced to have a certain amount of capital due to high regulation and the numerous of rules put forward by local governments and international financial supervisory boards like the Basel Committee. In Poland capital is very costly and is hardly accessible and thus creates high barriers of entry, since this can make it hard for new banks to start up[93].

Furthermore, given the nature of the country's history Poland is the country with the second largest administrative start up burdens connected with starting a new business. Starting up a new business in Poland costs three times as much and requires an increased amount of time when comparing to the average OECD country. This is highly connected with the issues such as the

[90] The Economist Intelligence Unit. "Industry Report: Financial Services"
[91] Nordea AB Annual Report 2010
[92] European Central Bank. "EU Banking Structures"
[93] OECD. "Economic Surveys: Poland"

inefficient- government, bureaucracy, inconsistency in tax regulations and political instability that the country has experienced in the last decade[94]. In addition to this, it can be very costly to start up new branches, finding the rights employees (especially IT professionals), having secure IT systems and establishing a well-known brand.

On the other hand, when looking at how banks in Poland (and in general) earn income from commissions and fees, it can be argued that the barriers are very low. Offering financial services, brokerage and currency exchange does not require a solid capital base and is not too costly. In 2009 25% of total banking activities were commissions and fee income[95]. This together with the fact that many bank customers have a preference of favouring to pay the lowest possible fee for these services makes it possible for new banks as well as competing banks to steal customers from each other.

Additionally, it has become very attractive and is a very good source of income for industrial companies to offer small and short-term consumer credits. By doing this, they are able to offer both the end product and the financing solution to the customer[96]. Even though these loans only currently account for a small fraction of the total income generated by banks in Poland, these loans are the ones with the highest interest spreads and the demand for them is growing, which can be very beneficial on a large scale for those companies who provide these loans.

From the above is seems that the barriers of entry for new banks entering Poland are relatively high. One could argue that this was somewhat different in practise given the massive increase of banks seen in the country in recent years. One should however keep in mind that the increase/inflow primarily was caused by larger international banks, that already had access to the required capital.

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[94] OECD. “Economic Surveys: Poland”
[95] PFSA. “Report on the Conditions of Polish Banks in 2009”
[96] The Economist Intelligence Unit. “Industry Report: Financial Services”

3.2.2.3 Threats from Substitutes Products or Services

In Poland the demand for financial services and lending has been somewhat limited following the historical development of the country.

Nordea AB currently offers a wide range of attractive and complex products on an international scale. However, the demand for such products is very limited in Poland and thus Nordea Poland only offers the most standardised products in Poland. Given the high number of banks in Poland (as discussed earlier in this section) and the limited demand for financial service products, it can be argued that the threat arising from substitute products is very high. In general the threats that arise from possible substitute products or services are relatively high in Poland since many banks offer similar products and services. This in turn forces banks into price competition or makes them focus on customer loyalty and satisfaction.

One interesting aspects in Poland is the fact that companies currently tend to access capital by lending directly from banks and not by issuing bonds[97]. However, assuming that the country recovers from the economic downturn and the banking sector constantly develops, one could get the idea that this could change going forward, especially considering the fact that issuing bonds gives easier access to capital and is above-all cheaper.

3.2.2.4 Bargaining power of suppliers

Banks in Poland are not dependent on numerous suppliers like it is the case for industrial companies. However there are a few factors that can influence the bargaining power of the supplier.

The main issue concerns capital supply as banks need capital in order to be able to offer loans. Capital can be accessed in many ways but there are three main ways of accessing capital. First, it

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[97] The Economist Intelligence Unit. "Industry Report: Financial Services"

can be accessed through deposits form governments, individuals and corporate businesses. Second, banks can access capital through issuing shares or senior and subordinated debt (or the like). Thirdly, banks can turn to the interbank market where they can access capital by borrowing from other banks. However, borrowing on the interbank market can be very risky and costly. This was illustrated during the sub prime crisis where capital was very limited and exceptionally costly. Generally most capital comes in form of deposits. There has however been a general tendency among banks in Europe to move away from accessing capital from deposits towards accessing capital by issuing new debt[98]. The tendency is only observed very limited in Poland but can however change as the sector continues to develop.

There are several other threats arising from the bargaining power of the suppliers. First of all, a bank requires a solid work force in order to be able to operate on a daily basis. Given Nordea Poland's strategy it requires highly qualified personnel. However, since employees are able to move relatively free from one bank to another, the threat following this can be relatively high. Additionally, banks require a decent level of infrastructure (especially in connection with IT) and thus they are dependent on the suppliers of this. In Poland the supply of infrastructure is very limited and still developing, entailing that banks can be threatened by the limited number of suppliers.

Generally, it can be argued that the number of threats arising from the bargaining power of suppliers is very low due to the easy access to capital as well as the over supply of employees. However, given the nature of the banking business this can vary from time to time dependent on the cost and accessibility of capital. During an economic downturn the access to capital is very limited and very costly and can create high bargaining powers of suppliers. The opposite is the case in an economic upturn.

[98] European Central Bank. "The Determinants of Banking Capital Structure"

3.2.2.5 Bargaining Power of Buyers

From a starting point bank customers (the buyers) can choose any bank they think provides them with the necessary and satisfactory service and products. Given the reasonably high number of banks to choose from in Poland it seems that buyers have relative high bargaining powers. To limit the bargaining power banks need to differentiate themselves to attract and maintain customer. Given the nature of the industry, banks do not compete on price or product but use means such as service and customer satisfaction. In Poland, however, this tendency is relatively new and thus has a limited impact on the bargaining power of the customer.

On the other hand, given the high switching costs that are connected to moving from one bank to another, it seems the bargaining power of the buyer is relatively low. Moving mortgage loans, car loans, credit cards etc. can be very tough and be very costly and thus gives the buyer limited bargaining power.

Generally, it seems that buyers in the Polish banking have medium to high bargaining powers very much dependent on the size of the switching cost.

For a brief summery of the threats/forces that have an influence on the Polish banking sector please see appendix 8.2.

3.3 The Current Nordea Poland – In the Middle of the Road

Nordea Poland's growth in Poland during the last couple of years has been impressive. The bank has been able to establish itself in a country during an economic slowdown and in an environment characterised by high and intensified competition from many local and foreign players. The question now is whether Nordea Poland will be able to keep on growing and whether the bank will be able to reach the actual goal of its strategy in Poland. In the following section Nordea Poland will be analysed internally to identify the possible strengths and advantages the bank has and whether these will help the bank to grow going forward.

3.3.1 The current Nordea Poland

To analyse Nordea Poland from an internal perspective a SWOT analysis will be used as a starting point. SWOT is an acronym for the following factors:

- Strengths
- Weaknesses
- Opportunities
- Threats

The strengths and weaknesses are seen as internal originated attributes of the bank and the opportunities and threats are seen as external originated attributes of the bank.

3.3.1.1 Strengths

When looking at the strengths that Nordea Poland has there are several issues that are worth mentioning. First of all, Nordea Poland seems to have been able to adapt quickly- and make use of the mother company's concept of banking, which has allowed the creation of a very strong and transparent banking model in Poland. This gives the bank an opportunity to draw on the synergies from the transparent banking model and thus makes it possible to offer customers better products- and more importantly better services. Service is one of the key aspects of banking at Nordea Poland and this has recently made the bank award-winning[99]. The reason behind this increased service-mindedness must be related to the fact that it is a general belief in the banking industry that increased service towards customers is the core way of achieving organic growth[100]. This is also illustrated with the fact that Nordea Poland currently focuses on primarily offering service minded products to its clients in Poland[101].

Another strength related to Nordea Poland is the banks capital base. The mother company of the bank currently has a very strong capital base and Nordea Poland is able to take advantage of this. The fact that Nordea AB did not engage in the Banking Pack II (Bankpakke II) in Denmark

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[99] Nordea.pl
[100] Feig, Nancy. "Customer Satisfaction Is Key to Driving Organic Growth at Banks"
[101] Nordea.pl

shows how strong the capital in the group is[102]. The capital base in Poland is currently also very strong following a share capital increase in 2010 and the bank is currently well above the capital requirement of the country.

One last issue in connection with Nordea Poland's strengths is the banks focus on having a high level and secure IT solution. This is illustrated with the fact that the bank has incorporated its famous Solo system in Poland[103]. A system that the mother company uses with great success in Scandinavia. The bank currently offers many products that are Internet-based products and thus is forced to have a good IT infrastructure. Having a solid IT foundation for its product offering makes it easier for the bank to approach the customer with the right product.

3.3.1.2 Weaknesses

Turning to the weaknesses at Nordea Poland it seems that on the surface these are relatively few. However, there are a few disadvantages that the bank currently is farcing. First of all, given the fact that customers in Poland currently do not demand complex financial products it could be argued that the banks universal strategy is of little use in Poland. This could lead to inefficiencies and resource overflow and could in the end mean the bank would have to focus more on cost-competition. On the other hand, it must be mentioned that this concern must be view as a short-term issue. Given the rapid expansion that the Polish banking sector currently is experiencing, one must think that demand for more complex and services will increase in the longer term.

Another issue that could be a concern for Nordea Poland is the fact that the bank has a rather large mismatch in its funding structure. Given the fact that Nordea Poland has (and is expected) to increase it's lending in Poland, the bank is forced to find sources of funding to accommodate the capital requirements in the country. However, it seems Nordea Poland has not yet been very good at attracting deposits, which in turn would mean the bank is forced to find alternative ways of financing its business activities. One alternative way is to issue new shares. However, Nordea

[102] Venderby, Christian. "Nordea taker nej til bankpakke II"
[103] Nordea.pl

Poland has already for several times issued new shares, especially during the latter years, and at some point the bank will not be able to dilute is shares even further, despite the fact that the mother company owns majority of the shares. This would in turn mean the bank would be forced into other and increasingly more expensive ways of financing, especially considering the fact that the bank desires to grow organically.

The last issue worth mentioning in connection with weaknesses of Nordea Poland is the bank's current exposure to the housing market in Poland. Close to 50% of the loans, that Nordea Poland has been issuing, are mortgage loans and thus makes the bank highly exposed to the housing market in Poland[104]. Given the current tendencies in the housing market Nordea Poland runs an excessive risk of increasing its loan losses in the country.

3.3.1.3 Opportunities

When looking at the opportunities that Nordea Poland currently is facing there are several issues to note. First of all, given the current macro environment in Poland the bank will be faced with a range of opportunities, that could be caused by the general economical development. First, since demand for consumer loans is increasing and consumers generally are spending more Nordea Poland will have the opportunity to increase its consumer lending as well as offering more payment and transaction services and thus increase its bottom line. Furthermore, given the fact that interest rates are expected to increase in the short term, Nordea Poland will be able to charge higher rates on its lending, especially on its mortgage loans allowing an increase of it's net interest margins.

There are also opportunities for Nordea Poland when looking outside the macro economical environment. Nordea Poland will have access to a great amount a well-educated labour at a reasonably low cost following the large increase in the educational level in the country. This is in

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[104] Nordea Poland Annual Report 2010

great line with the banks overall strategy to attract and maintain employees with high levels of knowledge, that are highly motivated.

3.3.1.4 Threats

Turning to the threats that are currently facing Nordea Poland there are also several issues to note. First of all, the general instability in the country and the increased competition in the financial sector will make it hard for the bank to achieve its main growth targets. Adding to this, comes the increased focus on banking regulation (like for example the new Basel III rules) and the ambiguous bureaucracy that has been directing the country during the last decade.

On an economical level Nordea Poland is challenged by the increase in loan losses that the bank has been experiencing especially during the last years. This can be a threat to the bank if defaults and insolvencies from mortgages loans increase due to declining house prices.

For a summary of the most important topics that were touched upon in the SWOT analysis please see appendix 9.

3.3.2 The Future of Nordea Poland and its Growth Strategy

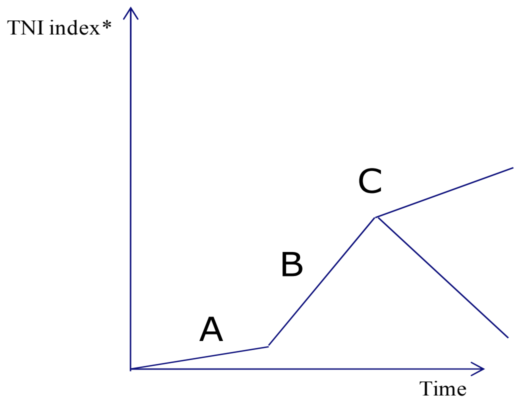
Nordea Poland entered the Polish market by acquiring several local banks. The bank has grown rapidly and has increased both its number of employees as well as its lending activities dramatically. In the case of Nordea Poland it seems the idea of growing through acquisitions is seen as one of the least expected, even though the bank was one of the seven banks that were considered interested in acquiring Bank Zachodni WBK S.A. in the mid of 2010[105]. According to Thomas Neckmar (head of Nordea AB's Emerging European markets) the main method to achieve growth for Nordea Poland is to grow organically and to grow by around 30% per year measured in terms of expanding its loan portfolio. This is furthermore backed up with the fact

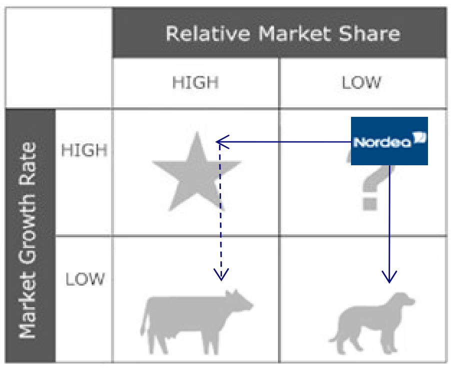
[105] Børsen Finans. "Medie: Nordea vil købe bank i Polen"

that organic growth is considered to be the best method in which banks can achieve long-term value[106].

However, the bank does not reject the idea of acquiring other banks in Poland to strengthen the banks basis[107]. Important when doing so, is to find a bank that fits into the "Nordea way of banking" otherwise the acquisition can ultimately have a negative effect on the overall growth target[108].

The best form of growth that describes Nordea Poland is an accelerating internationalisation strategy. This strategy is characterised by three main phases (see figure on the left below). First, banks start internationalising by entering a given market by forming alliances, networks or acquiring smaller banks. Following this banks expand considerably by either acquiring a number of other firms or by having enormous organic growth. The last phase is two-sided. Either banks start consolidating and focus on internal growth or banks are forced to exit due to strategic failure[109]. Using this to describe Nordea Poland's current situation it seems the bank is in the middle of the road (phase B), where its main desire is to expand massive through organic growth.





Source: Own creation inspired by Slager (2004)

Source: Boston Consulting Group

*TNI index = Transnationality Index (indicator for internationalisation)

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106 Feig, Nancy. "Customer Satisfaction Is Key to Driving Organic Growth at Banks"
107 Kronenberg, Kasper & Munksgaard, Pia G. „Nordeas fundament i Polen er organisk vækst"
108 Kronenberg, Kasper & Munksgaard, Pia G. „Nordeas fundament i Polen er organisk vækst"
109 Alfred Schalger

Using the famous Boston Consulting Group Matrix (BCG Matrix) this can be illustrated even further. Currently, Nordea Poland has a limited to low market share in Poland and the market growth rate in Poland is reasonably high. This places Nordea Poland in the top right corner and categorises the bank as question mark (see figure on the right above). At this state, it is unclear whether Nordea Poland will be able to succeed and become a star/cash cow or whether the bank will take the disaster route and become a dog.

Turning to banks main strategies using a Porter terminology[110], it seems Nordea Poland has been able to succeed and is on the right path to achieving its growth and financial targets. Given the nature of the banking industry in Poland, banks are primarily focussed on perusing a cost leadership strategy to be able to attract and increase the number of customers. However, Nordea Poland has chosen a path where the bank has been able to create a competitive advantage over other banks in Poland due to its core business model; the *one banking model* that is has transferred from the mother company. Nordea Poland has been able draw on the synergies of this banking model and has created a generic strategy, where it peruses a differentiation focus that evolves around the customer and its transparent banking model. This is illustrated in a number of ways.

First, Nordea Poland does not compete on prices but rather focuses on delivering the best and most superior products that fits the demands of the customer. Given that Nordea Poland was able to incorporate such a efficient and transparent banking model the bank has been able to free up resources and thus it is able to offer better products and service to its customers. Nordea Poland currently only offers a limited amount of products to its customers in Poland. Going forward however, the bank will be able to offer more and more products and thus offer products that their competitors do not due to its *one banking model*. Furthermore, a clear example of the fact that Nordea Poland has chosen not to compete on prices, is that the bank currently is among one of those that have the lowest interest rate margins in Poland[111].

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[110] Quoted in McGee, John & Thomas, Howard & Wilson, David. “Strategy: Analysis and Practice”
[111] This will furthermore be discussed in the financial analysis.

Second, Nordea Poland has put the customer in the centre of its banking model and has focussed on delivering high quality service and service solutions to its final customers. This is mirrored in the numerous prices the bank has been awarded with as well as the fact that the bank has a large and successful online banking system[112]. Furthermore, the bank has a large amount of service products available and thus gives the customer many options for doing their banking business. A very good example of the increased focus on delivering high service to its customers is the fact that bank recently (14th of February) updated and improved its corporate website. This was done to increase transparency in the information towards its customers as well as to be more user-friendly in the ways the information is communicated[113].

Thirdly, Nordea Poland focuses on being able to deliver the most of what customer demand. By having a focus on employing high-qualified personnel, the bank has access to knowledge that will be an advantage when having to serve customers. This will in turn both increase the service the customer experiences as well lead to an increase in the brand-recognition and reputation of the bank.

Generally the strategy, that the bank has chosen, has made the bank grow massively in the last years. By transferring the *one banking model,* the bank has been able to create an advantage over others in the industry, which can be very successful for the bank in the long run. At the current state, it has only just started to create short-term value and Nordea Poland is still in a developing phase (in the middle of the road). However, the model most likely will be able to create long-term value for both customers and shareholders. Going back to the BCG Matrix terminology it seems Nordea Poland is moving towards becoming a star, if not a cash cow, in the long run.

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[112] Nordea.pl
[113] Nordea.pl

4. Financial Analysis

The financial analysis in combination with the strategic analysis makes out the basis of the forecasting/budgeting and the valuation of Nordea Poland.

4.1 Accounting practices

Nordea Poland's financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) and the rules from the Financial Reporting Interpretations Committee (IFRIC) governed under the EU Commission. The original financial statements are prepared in Polish and are hereafter translated into English. The currency used in the statements is thousand Polish zloty. The accounting standards, policies and calculations have been identical throughout the years from 2005-2010. Changes have only been made in connection with presentation layout and the like.

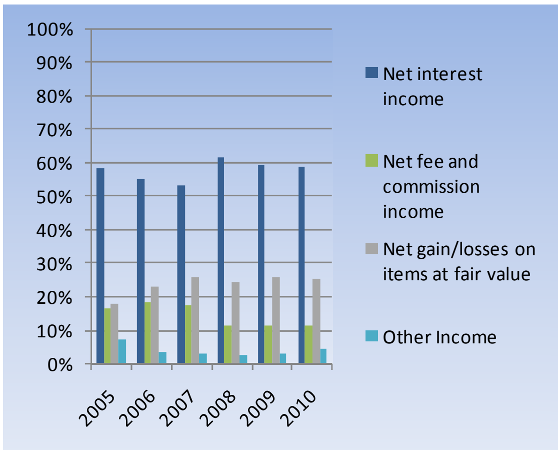
4.2 Income Statement Items

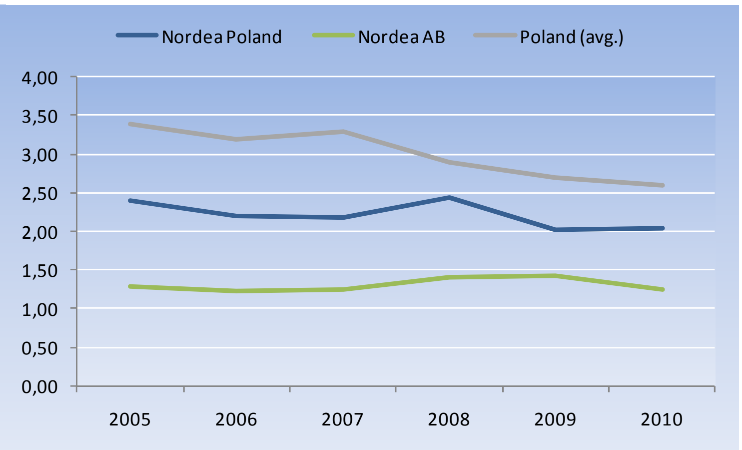
To get a good overview of how Nordea Poland has been performing during the last years, it is useful to start of by looking at the income statement (for a total income statement for the years 2005-2010 please see appendix 10).

When looking at the income statement, it is evident that there has been steady increase in operating income throughout the last 6 years. Operating expenses have also been increasing throughout these years, but have only had a limited effect on the increase in the banks net profits.

The net profits have increased from 30.727 tPLN in 2005 to 259.337 tPLN in 2010, which is an increase of 7,5 times. When comparing Nordea Poland's net income to some of its peers it becomes clear that Nordea Poland has been performing well, especially during the financial crisis (see appendix 12.1 and 12.2 for details on peer group income and income changes). Since 2005 the average peer income increase was only 18% where majority of the peers recorded losses in 2009.

Looking at the income side of the income statement one can observe that Nordea Poland earns its majority of income from its net interest income and that these have been somewhat stable during the years measured in relative terms to total income (see figure on the left below).





Source: Nordea Poland Annual Reports 2005-2010

Source: Economist Intelligence Unit

From this it is obvious to look at the banks interest rate margins. Turning to these at Nordea Poland (figure on the right) it becomes clear that the bank has been very good at generating income on its loans when comparing to Nordea AB. Remarkable is the fact net interest margins in Nordea Poland have been around 55-95% higher than the margins in the mother company. This can, however, to a great degree be due to the fact that interest rates a reasonably higher in Poland, enabling to use larger spreads. When comparing to the average net margins earned from banks in Poland, it seems that Nordea Poland is lagging behind. During the last years Nordea Poland has had margins between 16-34% lower than average margins in Poland. Interestingly, despite these reasonably lower margins the bank is still able to constantly increase its net income from year to year. The general decrease observed in interest rate margins seen at Nordea Poland and in Poland in general, can be related to the sharp increase in the level of competition in country as well as the low levels of interest rates (relatively seen), that have dominated the financial sector for the last years. Looking forward, one could be pessimistic regarding net interest margins, since interest rate levels seem to have stabilised at a very low level.

The second largest source of income for Nordea Poland is connected to net gain/losses of instruments at fair value. These include gains and losses from assets and liabilities caused by changes in fair value as well as gains and losses from financial assets and liabilities, that are denominated in foreign currencies. Given the fact that Nordea Poland is very limited active in earning income from trading securities and instruments in the financial markets these incomes can greatly be connected to the loans the bank has given in foreign currency[114]. In 2010 most of net income connected to net gains/losses of instruments at fair value were connected to the loans in foreign currency. The income in connection to this has been increasing with 30-50% during the last six years, and majority of this increase is connected to either exchange rates between PLN and CHF or PLN and EUR[115].

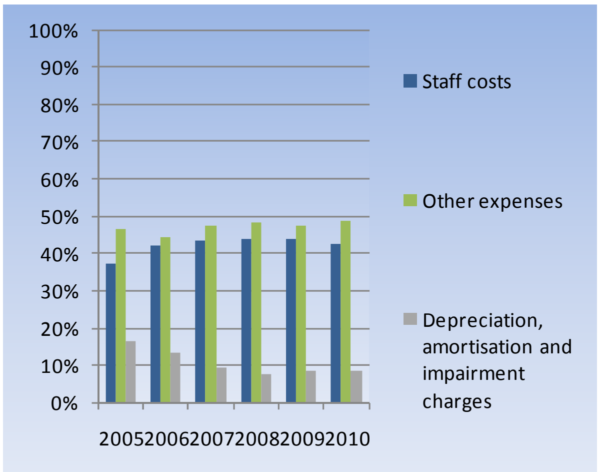
Nordea Poland also earns a reasonable amount on fees and commissions especially from payment and card-transactions. The bank has been able to grow its source of income from fees and commission between 20-30% on a yearly basis during the last six years and especially in 2010 the bank was able to increase this source of income (32%). This can be related to the constant increase of new customers that generally need to be serviced on a regular basis. Additionally, the bank has been able to offer a variety of products targeting customers with different needs and as a consequence, Nordea Poland has been able to increase the fee income. Examples of these products are the bank's gold, silver and bronze membership accounts as well as the bank eFirma accounts. Going forward Nordea Poland can, however, experience increased competition, since it has been easier for non-financial firms to offer payment services and these may have forced

[114] Nordea Poland Annual Report 2010

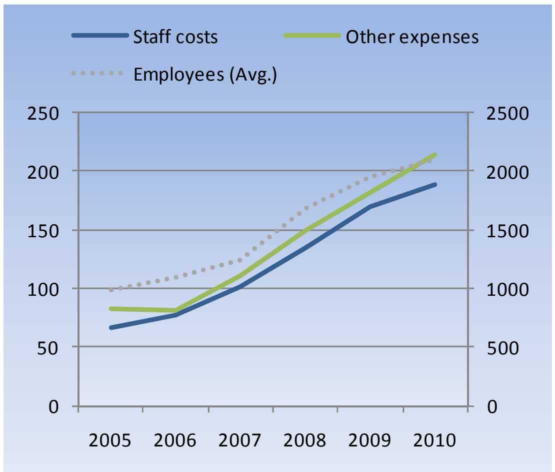
[115] Nordea Poland Annual Report 2010

Nordea Poland to charge lower fees on payment and credit-card transactions. Furthermore, there is a tendency among customers to favour the lowest possible fee, when having to carry out these sort of banking activities.

Turning to the expense side of the income statement one can observe that the largest expenses the bank has either are connected to its staff cost or to the cost categorised under other expenses (see figures on the left below). Both of these have been steadily increasing during the five last years (figure on the right).



Source: Nordea Poland Annual Reports 2005-2010



Source: Nordea Poland Annual Reports 2005-2010

The increase in expenses connected to staff costs is connected to the fact that total number of employees in Nordea Poland has been increasing throughout the last six years. The majority of expenses connected to staff costs are related to either salaries or social security payments. Interestingly, the standard employee in Poland receives about 30% of the remuneration the standard Nordea employee earns[116]. Other expenses at Nordea Poland mainly cover expenses connected to IT costs, marketing, rents and general office expenses. These have also been increasing during the last five years and can to a great degree be linked to general growth, that the bank has been experiencing.

[116] Calculated on the bases of the Nordea AB Annual Report 2010

4.2.1 Cost/Income ratio

From the above it would be essential to look at the banks cost/income ratio to see how the income and cost have been developing relative to each other as well as to see how profitable the bank is. The lower the ratio is the better since this shows the bank has control over it expenses and not only focuses on making new loans. Sudden changes in the ratio can be an indication of new potential problems[117].

Cost/Income	2005	2006	2007	2008	2009	2010
Nordea Bank Poland	0,82	0,75	0,71	0,63	0,65	0,56
Nordea	0,56	0,52	0,52	0,53	0,50	0,52

Source: Nordea Poland (and Nordea AB) Annual Reports 2005-2010

Looking at Nordea Poland it seems the bank has good control over its cost since the cost/income ratio has been declining during the last six years. Comparing the numbers to the mother company it is interesting to note that Nordea Poland has been very good at bringing the ratio down. However the ratio is still very high when comparing the figures in absolute terms. This is a clear sign of that the bank still is in the start up phase and still has some way to go before it stabilises.

4.2.2 Profitability

The return on assets (ROA), the return on equity (ROE) and the earnings per share (ESP) are all good indicators of how well Nordea Poland has been in generating returns and earnings (see appendix 12.3 for an overview of these indicators for Nordea Poland and its peer group). ROA gives the investor an idea of how good the bank has been in using the total amount of asset to generate earnings. This figure is somewhat different when looking at a bank in comparison to industrial companies, since banks actively uses assets to generate income. For Nordea Poland the ROA has been varying from 0,52% to 1,15% (avg. 0,82%) in the period analysed and is somewhat lower in comparison to the average returns of its peers (1,67%). This is a clear sign, that the bank has not yet reached a phase were it has stabilised. When comparing Nordea Poland with the mother company, it quickly becomes clear that Nordea Poland has been yielding better returns on assets in the latter years. This can be related to the fact the Poland has not been affected by the financial crisis as much as other countries have.

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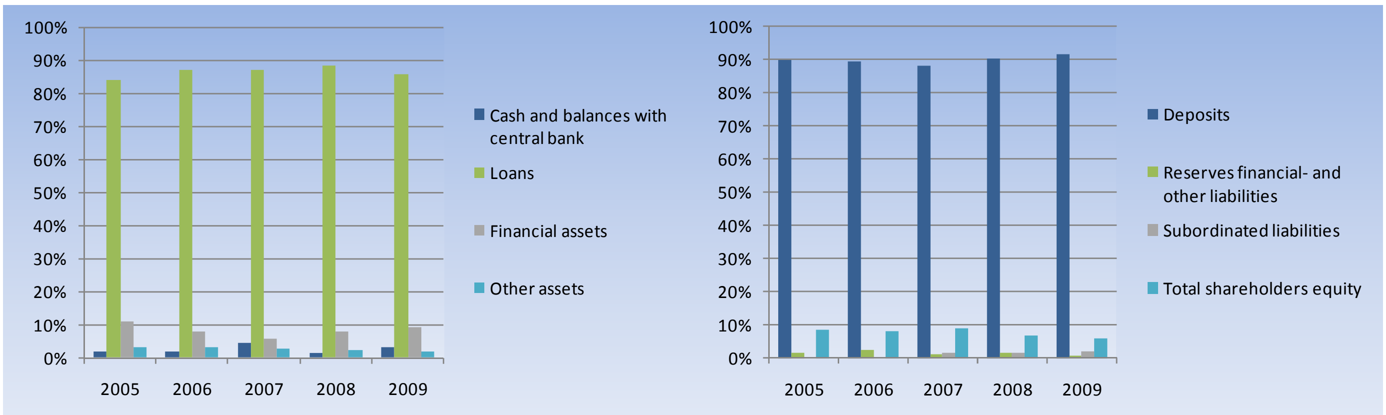
[117] Dermine, Jean. "Valuation and Value-Based Management"

Looking at ROE one can identify how good Nordea Poland has been in generating earnings with the money that shareholders have invested. The general average peer ROE has been around 12% for 2009[118] and is in line with what Nordea Poland has been able to return in the same year. However it should be noted that the average peer group ROE has decreased dramatically from 2008 through 2010 in the same time where Nordea Poland has been able to increase its ROE, and it thus seems Nordea Poland has been performing relatively better during 2009 and 2010 in comparison to its peers.

Turning to EPS similar tendencies are seen as in the ROE. The EPS shows how much of the banks profit that is attributed to each share outstanding and is a sign of how profitable the bank has been. Nordea Poland's EPS share is rather low in comparison to its peers. However, again the bank has been able to increase its EPS during a period where other banks did not.

4.3 Balance Sheet Items

Turning to Nordea Poland's balance sheet (for a total balance sheet for the years 2005-2010 please see appendix 11) there are also a few important issues that can be good indicators of the banks financial performance in the last six years

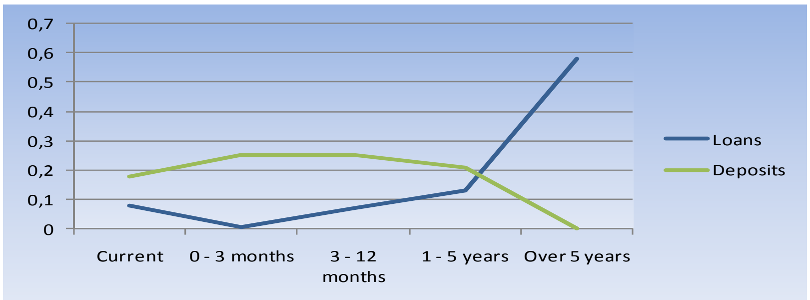


Source: Nordea Annual Reports 2005-2010

118 The 2009 figures has been used since the figures of 2010 are incomplete due to missing annual reports of some of the peer banks.

First of all it is important to see how the asset and liability sides of the balance sheet is put together. In terms of assets, the majority comes from loans to banks, corporate customers or individuals (87% in 2010). The remaining assets are mainly from either cash balances at the central bank, in form of financial assets or other assets. In terms of liabilities (and shareholders equity), the majority come in form of deposits from banks, corporate customers or individuals (90% in 2010). The remaining liabilities are primarily subordinated debt, shareholders equity and reserves as well as financial and other liabilities. Nordea Poland has been able to grow its loans and deposits significantly during the last years and given its strategy, it seems likely that the bank will do so going forward[119].

When looking at the maturities of the respective loans and deposit that Nordea Poland has, there are some interesting things to note (see graph below[120])



Source: Nordea Poland Annual Report 2010

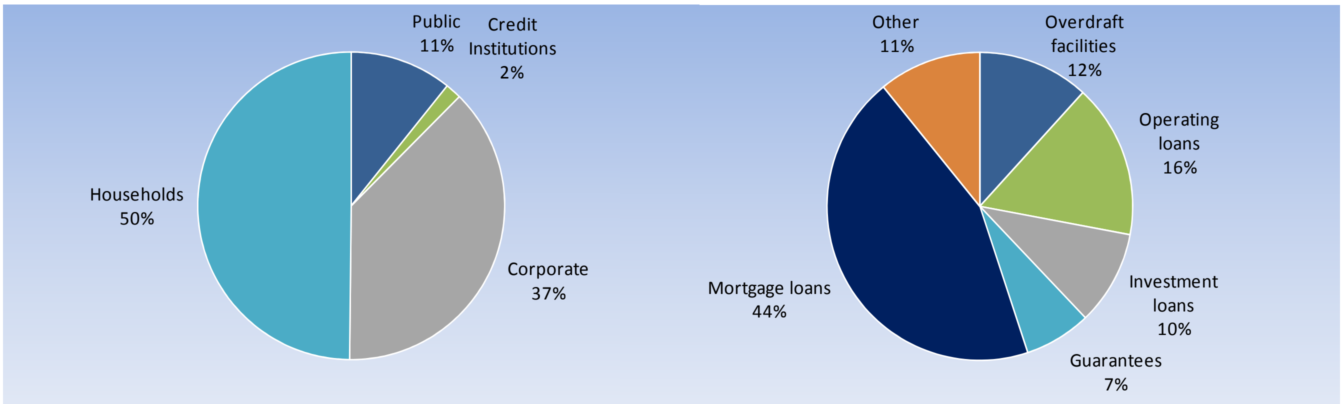
First of all, it seems that Nordea Poland when looking at shorter maturities (up to five years), has a great maturity match (in the sense that the bank is well funded) and is able to fund its operations through the banks deposits. However, looking at the longer term, Nordea Poland has a huge maturity mismatch and thus its average duration gap is very high. This can be very problematic and makes the bank increasingly exposed to several types of risks. First of all, following this mismatch the bank is very exposed to a great degree of interest rate risks and thus the bank needs to have vital controlling and hedging strategies in place in order to get around this matter. Furthermore, following this mismatch the bank is very vulnerable with respect to liquidity

[119] Nordea Poland Annual Reports 2005-2010
[120] The maturities of loans and deposits are measured relative to the total assets at the end of 2010.

risk especially in case a new financial crisis should arise. Not only will it be hard for the bank to find capital (which will be very expensive), the bank will also be exposed to so called bank runs, where customers withdraw their deposits in a matter of days. Other types of risks the bank is exposed to following this maturity mismatch are credit risk and operational risk.

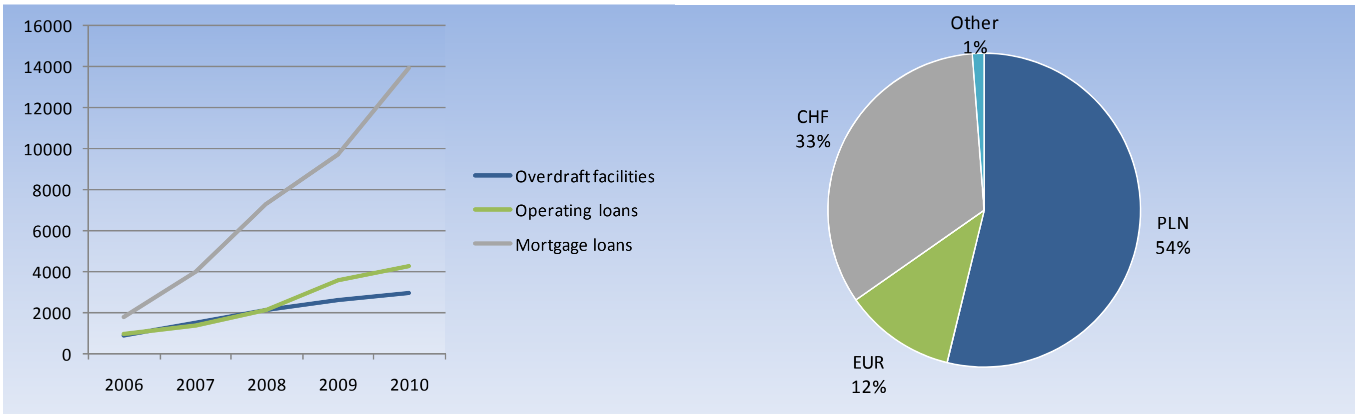
4.3.1 Credit Portfolio

When looking at the balance sheet it is also important to look at how the credit portfolio is put together. Not only does the credit portfolio give an idea about in which areas Nordea Poland is able to earn on its interest margin, but it also shows how well the bank has diversified its total credit risk. Nordea Poland's total credit portfolio has increased with 28% from 2009 to 2010. Nordea Poland has majority of its loans in the household segment and corporate segment (87%, see left figure below). Among the largest increases are the loans to households that have increased 43% and loans to corporate customers that have increased 24%. This is in great line with the tendencies seen in the sector in general, where demand for credit among especially households is increasing.



Source: Nordea Poland Annual Report 2010

Looking at the portfolio in terms of product type it becomes clear that majority of the loans, that Nordea Poland has issued either come in the form of mortgages loans, operating loans (includes loans such as credit card, car and consumer loans) or overdraft facilities. Nordea Poland has a very high exposure to the housing market in Poland since almost half of the credit portfolio is connected to mortgage loans. Nordea Poland has had the largest grow rates of loans in mortgage loans measured in absolute terms (see figure on the left below).



Source: Nordea Poland Annual Reports 2005-2010

Given the fact that house prices have been declining for the last years makes Nordea Poland increasingly vulnerable in connection with loan losses caused by defaults and insolvencies on housing loans, due to the banks high exposure to the housing market.

Looking at how the loan portfolio is spread in terms of currency (see right figures above) it becomes clear that Nordea Poland has close to 50% of its loan in foreign currencies especially in either CHF or EUR (other currencies include mainly USD, GBP, SEK and NOK). This makes the bank highly exposed to exchange rate risk, especially considering the fact that the local currency is free-floating and has been fluctuating quite a bit in the last years. Going forward, these risks could be reduced in the case where Poland would become member of the Euro.

In general it seems that Nordea Poland's loan portfolio is reasonably diversified, but it also seems that the bank exposed to several risks due to the composition of its credit portfolio, that could lead to a high level of loan losses.

4.3.2 Loan Losses

From looking at the composition of credit portfolio and the risks connected to this it would be rational to take a look at the loans losses (and the provisions for loan losses) at Nordea Poland (see appendix 12.4 for a overview of the loan losses of Nordea Poland an its peers). In the years from 2005-2008 the level of loan losses have been relatively low. However in latter years, Nordea Poland reported an extraordinary increase in these. This can be explained by the general financial and economic downturn, which has been dominating the sector during the last years as well as the fact that Nordea Poland has increased its credit portfolio dramatically causing a natural increase in the level of loan losses.

In general loan losses for Nordea Poland have been lying between 0,07-0,10% of the total loans outstanding and are relatively low in comparison to the banks peers (see Appendix 12.4). Notable is however, that loan losses have increased seven times from 2008 to 2009. This increase is very high given the fact that Nordea Poland's total loans only have increased with 24% in the same year. The development is mostly explained by the banks large increase of mortgage loans combined with the tendencies seen on the housing market in Poland. Putting Nordea Poland's figures into perspective by comparing them to the loan losses of the mother company (0,50% of total loans) it becomes clear that losses have been very limited in Poland. Given the fact that Nordea Poland has a relatively low ratio of loan losses to total loans in comparison to its peers, one could get to the conclusion that the banks has high credit rating standards and has been very good at giving high quality loans.

4.4 Capital Adequacy at Nordea Poland

Turning to the capital adequacy at Nordea Poland a good starting point is to look at the legislation that the bank is subject to.

4.4.1 Nordea Poland and the PFSA

Nordea Poland is subject to any legislation in connection with principles and methods on measuring capital adequacy put fourth by the Polish Financial Supervision Authority (PFSA).

The PFSA became responsible for banking supervision in Poland in 2006 and is supervised directly by the President of the Council of Ministers. Since 2006 the PFSA has formulated increased and more precise capital requirements to ensure market security, stability, transparency and confidence in Poland. Nordea Poland is thus subject to the latest resolutions (the Financial Supervision Commission Resolution 383/2008 & 385/2008) that were introduced in Poland following the Basel II Accords and the Capital Requirement Directive put fourth by the European Commission.

4.4.2 Capital Adequacy at Nordea Poland

In general Nordea Poland attempts to have a safe level of capital to risk, while at the same time seeking to optimize total long turn return of capital. When calculating the capital requirements, the bank performs the capital adequacy calculations in accordance with the standards required by the PFSA as well as in accordance with standards from the banks own internal capital requirement. The latter is done to ensure that the bank is even better capitalised, than what is expected by the authorities. The capital requirement with the highest minimum will be the binding one. Thus, if the highest capital requirement is calculated using the internal requirements, this will be the binding one.

When calculating the capital requirements Nordea Poland includes several calculations of risk following the resolution 380/2008 and the resolution 335/2009. These risks include:

- Credit risk (including counterparty credit)
- Settlement risk
- Market risk (risk associated with prices of securities and currencies)
- Operational risk

Most of Nordea Poland’s capital requirement comes from its exposure to credit risk. The composition of the banks loan portfolio determines the banks risk weighted assets, which in the turn compromises the capital requirement for credit risk.

Nordea Poland's settlement and market risks are very limited and therefore are not subject to any capital requirements[121]. This is illustrated by the fact that Nordea Poland has an overall strategy of minimising open market positions in currencies and interest rates at the end of each day. Furthermore, Nordea Poland does not engage in trading equities or debt instruments[122].

When measuring its operational risk Nordea Poland uses the Basic Indicator Approach. This is a single indicator used as a proxy of the institutions total operational risk[123]. The capital requirement for the banks operational risk is also very limited and only accounts for a fraction of the total capital requirement.

4.4.3 Capital Base

When it comes to the bank's capital base Nordea Poland categorises its capital in two sub classes. First there is what the bank calls its own funds (Tier 1 capital), which primary includes the share capital (carried at nominal value), the equity reserve (surplus value of the shares over the nominal value plus the allocated profits) and the capital reserve (primary includes revaluation of fixed assets). The second class is categorised as the banks additional own funds (Tier 2 capital), which includes components of complementary funds, items of supplementary funds (including subordinated capital) and short term capital (contains profit/loss from the daily trading book). Most of Nordea Poland's capital comes from share capital, retained earnings or subordinated loans.

Below there is a brief overview of Nordea Poland's capital requirement and its capital base at the end of 2009 and 2010[124] (for details of these please refer to appendix 13).

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[121] Nordea Poland Capital Adequacy Report 2009
[122] Nordea Poland Capital Adequacy Report 2009
[123] BIS.org
[124] The figures for 2010 are approximate figures since a detailed overview of the bank's capital requirement and capital base have not yet been published.

Capital Requirements	2009	2010 *
Credit risk	1.114.969	1.424.761
Settlement risk	-	-
Market risk	-	-
Operational risk (BIA)	52.481	62.977
Total	1.167.450	1.487.738
Capital base	**2009**	**2010 ***
Total own funds	1.014.623	n/a
Total additional own funds	410.236	n/a
Total capital base	1.424.859	2.017.745

Source: Nordea Annual Report 2010 and Capital Adequacy and Risk Management Report

To ensure and maintain a sufficient level of capital going forward Nordea Poland pursues several different strategies. First of all Nordea Poland does not payout any dividend (or only a limited amount as it was the case in 2006), but retains any given profit to increase capital. Second the bank regularly recapitalises in terms of issuing new shares to further increase core capital. The latest recapitalisation was carried out during mid 2010. In addition to this, the bank actively looks for opportunities to issue subordinated debt. This can be done through the mother company or through any of the bank's sister companies. Furthermore, the bank can access funds by getting a guarantee for its credit portfolio (either from the mother company or in the market) or by fire-selling assets or reducing specific credit exposures[125].

4.4.4 Capital Adequacy Ratio

The aim of Nordea Poland is to have a Tier 1 capital ratio of minimum 6,5% and a total solvency ratio (also known as TCR – total capital ratio) of minimum 9,0%. In 2010 Nordea Poland's Tier 1 capital ratio was 8,93[126]% (6,95% in 2009) and its total solvency ratio 10,85% (9,76% in 2009). During 2010 Nordea Poland has strengthened its capital base due to an increase in share capital as well as following an increased amount of retained earnings.

Putting these capital adequacy ratios into perspective one should note that Nordea Poland in comparison to Nordea AB has a relatively high level of capital in Poland. However, in comparison to its peers these are not that impressive. Nordea Poland has as mentioned earlier currently a TCR of 9,76%, Nordea AB a ratio of 11,50% and the peer group an average of

[125] Nordea Poland Capital Adequacy Report 2009
[126] The Tier 1 capital ratio for 2010 is estimated using the annual report of 2010.

13,47% (see appendix 14 for peer group figures). The high average in Poland could be an indication that other banks in the country desire a higher level of capital than what is required by them by law, in order to be able to absorb a sudden rise in the level of loan losses.

5. Budget and Forecasts

5.1 Part Conclusion

From the strategic and financial analysis there are several main points that have an influence on Nordea Poland going forward. These will briefly be summarised below.

First, the environment that Nordea Poland operates in has been developing in favour of bank. The recent political transformation has had a great impact on the economy as well as on the labour market in the country. GDP growth rates have been high, inflation under control and there has been a decrease in unemployment. This has furthermore increased consumer spending and demand for consumer loans and these are also expected to have a positive trend going forward. Adding to this are increased social standards as well an increased focus on improving the technological sector in the country.

Second, the banking sector in Poland has experienced a dramatic growth following the recent economical development in the country. This has caused a boom in the number of banks in Poland, which in turn has intensified the degree of competition in the sector. Lending activity has been growing for the last decade and the demand for banking products is constantly increasing.

Third, Nordea Poland has been able to introduce and operate a strategy in Poland that is different from the normal banking business in Poland. This has been possible by transferring the mother company's core banking model to the bank in Poland. Nordea Poland has from this drawn on the synergies of the mother company, allowing the bank to develop a competitive advantage while also avoiding the fierce competition on the market. By offering a range of products and services of high quality, Nordea Poland will be able to engage in long term relationships with its customers as well as be able to attract new customers. This in turn will be profitable for the bank in the long run.

Fourth, Nordea Poland has been able to grow its net income in Poland dramatically during the last five years. Even though the banks net interest margins currently are not too impressive, the bank has been able to grow its loan portfolio and thus has created future income potential. Currently, Nordea Poland focuses on attracting and maintaining an increased number of customers and this is the central reason to as why its current interest margins are relatively low. Going forward, the bank will be able to take advantage of these customers by charging increased margins and fees.

Lastly, Nordea Poland's current capital structure seems very strong. The mother company of the bank has a strong capital base and has several times injected capital into Nordea Poland. Furthermore, Nordea Poland has during most of the last years retained all of its earning into the capital of the bank, in order to strengthen capital position. This makes it easier for the bank to fulfil its organic growth strategy, since the funding is easily obtained and cheap.

5.2 Time Horizon

The first step in the forecasting process is to determine the number of years to be forecasted and how detailed the forecast should be. Usually one uses a three step time horizon. The first phase is an explicit and detailed forecast period and normally spans over three to five years. In this phase complete details on the company's income and performance are developed to mirror the most possible outcome for the company in the period. Following this phase a more simplified forecast period is used where one focuses on few constant growth rates to reflect the longer-term performance and trends of the company. This phase normally spans until the tenth year into the forecasted period (i.e. from year 3/5 – year 10). The last phase is the phase where the company growths at a constant rate, where one values the remaining life of the company using a continuing value.

In this valuation a forecast period of 10 years will be used. First, a detailed forecast will be made for the first three years and for the next seven years, a more simplified forecast will be used until the phase last phase where the remaining life of the company will be valued using the continuing value.

5.3 Key Indicators

The strategic analysis illustrated the macro-and microeconomic environment Nordea Poland is operating in as well as the current strategic focus of the bank. The financial analysis showed how well Nordea Poland currently is performing and how the bank has been performing in the past. The following section will draw on the previous analysis in order to estimate key factors and growth potential, that will be used in the final valuation of the bank.

Key figures that will be forecasted are:

- Total operating income
- Total operating expense
- Net loan losses
- Income tax expenses
- Total net income
- Total capital requirement
- Changes in equity
- Other comprehensive income

5.3.1 Total Operating Income

Most of the future total operating income will in the case of Nordea Poland come from the bank's ability to earn net interests, net gains/losses of items at fair value and to a limited degree on fee and commissions (see appendix 15.1 for a summery of the forecasted operating income). Following the economical development in Poland and Nordea Poland's ability to attract new customers, it is estimated that it will be possible for the bank to grow its loan portfolio and its net interest income significantly. An interesting issue in connection with this, is the fact that given the sectors limited credit growth currently observable, one could assume that Nordea Poland will have a hard time increasing its lending as it would have to engage in fierce competition with other banks to do so. This is where Nordea Poland will be able to draw on the synergies from the adapted banking model of the mother company, and in line with this be able to attract the customers needed to create the necessary growth.

From this it is estimated that the bank will be able to grow its loan portfolio with 30% in 2011, 27% in 2012 and 17% in 2013. After this the bank will be able to grow by 9% until the end of the forecast period. The loans, that are expected to grow the most, are (among others) the overdraft facilities, the operating loans and the mortgage loans. (See appendix 15.2 for specification of expected growth of the different types of loans until 2020).

Given the current levels of interest rates and the tendencies currently observable in Poland, it is expected that Nordea Poland will be able to take advantage of the increase in interest rates and thus will be able to increase the bank's current net interest margin in the long run. Nordea Poland's current interest margins lie at around 2%, which is considerably below the average seen among its peers. It is estimated that Nordea Poland in the long run will be able to earn at least the same net margins, that the average bank in Poland is earning. However, given the fact that Nordea Poland currently is forced to offer low interest rates to attract new customers, the interest rate margin will remain below average during the explicit forecast period. From this it is estimated that Nordea Poland will earn a margin of 1,9% in 2011, 2,0% in 2012 and 2,2% in 2013. Going forward the net interest margin is expected to stay at a constant level at around 2,5%.

From these figures the net interest income for the forecasted years, are being calculated on the basis of the forecasted increase in the banks loan portfolio and the forecasted development in the net interest margin[127]. Following this, net interest income is expected to increase with 33% in 2011, 35% in 2012, 34% in 2013 and 28% in 2014. Hereafter, net interest income is expected to grow at a constant rate of 9%.

In regards to the gain/losses of instruments at fair value and revaluation of these, it is estimated that the banks income will grow largely in the three first years and thereafter grow at a constant rate. Most of the income in connection with these instruments is related to the banks foreign lending and since lending is increasing going forward, income in this sense, will also increase. Following this, income is estimated to increase with 20% in 2011, 15% in 2012 and 10% in 2013. Hereafter, the growth rate will be constant at 5% until the end of the forecasting period.

Turning to the income the bank generates through fees and commissions the pictures is somewhat similar to the increase observed in the banks net interest income. The fact that the bank constantly increases its customer base naturally means that the bank will increase its income from fees and commissions. Specifically, there will be an increase in the income from the transaction and payment service but also loan service fees will augment since the bank is increasing its loan portfolio dramatically. In the long run, however, it seems that competition could catch up with Nordea Poland forcing the bank to charge lower fees than it currently does. Pressures will mostly arise from price competition as well as the fact that customers will tend to favour using those services that are the cheapest (if not even free). The banks fee and commission income is thus expected to increase largely in the short-run, where after the income will stabilise at decent levels. In 2011 the fee income is expected to increase with 30%, in 2012 with 25% and in 2013 with 15%. Following this the fee and commission income will grow at a constant rate of 10%.

[127] Net interest income = Avg. earnings assets times the net interest margin. Avg. earnings assets is the average loan portfolio between two years (for detailed overview see appendix 15.2).

The banks last source of income the other operating income is very limited and only has a minor effect on the result as well as on the valuation of Nordea Poland. Even tough the other operating income increased with around 80% in 2010 the figures are very small in comparison to the bank's remaining income. Additionally, the increase in other operating income in 2010 is to a large degree generated from gains on IT projects as well as from reversals of provisions for litigations, and must thus be considered a disposable income. Given its limited effect on total income, the other operating income is expected to grow with a constant rate of 5% throughout the whole valuation period.

5.3.2 Total Operating Expense

Turning to the expense side it is clear that these will be growing somewhat in line with the estimated growth of the bank (see appendix 15.3 for a summery of the forecasted operating expense). Majority of expenses will be connected to the fact that the bank will be opening an increasing number of new branches throughout Poland and that the bank will increase its customer base significantly. The rise in the total operating expenses can be measured in several different areas.

First, staff cost will grow considerably, given the fact that Nordea Poland will have to hire more employees to be able to serve its increasing amount of customers. Furthermore, considering the fact that Nordea Poland desires to hire well educated employees to accomplish its strategy, these expenses can arguable rise even further. Nordea Poland has increased its employee base with an average of around 15% during the last years (excluding 2008 where it was increased by 30%). It is expected that the bank will need to hire at least 10-15% more employees for the next years to be able to fulfil the banks overall strategy. This is in great line with the fact that the bank expects to increase the work force in Poland with up to 500 new employees. Hereafter, it is estimated that the bank will hire 5% more employees on an average yearly basis. Adding the possible effects on wages (inflations effects, wages increases etc.) staff expenses are estimated to be growing with 20% in 2011, 20% in 2012 and 15% in 2013. Following this the growth rate in staff expenses will remain constant at 10%.

Next, there are a few things that will enlarge Nordea Poland's other expenses. First, the steady opening of new branches will lead to increased expenses in connection with having to pay rents and leases. Furthermore, Nordea Poland will see an increase in costs connected to IT, caused by the increased need of maintenance as well as on research and development of its current systems. Lastly, Nordea Poland will be forced to increase its spending on marketing to be able to attract the desired customers. From this, it is estimated that Nordea Poland's other cost will grow by 20% in 2011, 25% in 2012 and 20% in 2013. Here after the banks other expenses will be growing at a constant rate of 10%.

Expenses in connection with depreciation, amortisation and impairment charges of intangible and tangible assets are expected to grow at a constant rate of 5% going forward. This is linked with the fact that the banks depreciation and amortisation of assets is very limited. This will only affect the bank in a very limited manner, despite the fact that the bank is expected to grow rapidly going forward.

5.3.3 Net Loan Losses

Turning to the net loans losses (including provisions for these) there are a few things to note. First of all given the expected growth in the credit portfolio the net loan losses will certainly grow. Not because of decrease in credit quality, but simply because a fraction of the new issued loans run the risk of being defaulted.

Furthermore, given the outlook for the economy in Poland there are several other factors that could affect the net loan losses of Nordea Poland. Firstly, the current over-supply of housing in the market causes a downward trend in prices. This can eventually cause an increasing number of defaults on mortgages due to an increasing number of insolvencies and thus an increase in loans losses for Nordea Poland. Adding to this, is the relatively high (and uncertain) level of unemployment, that could cause many house owners to default on their loans. Given the fact that majority of the Nordea Poland's loans either are connected to the housing market or are overdraft facilities, the net loan losses is expected to grow especially in the short run.

Nordea Poland has recently experienced a dramatic increase of loan losses compared to the amount of total loans outstanding. Having this in mind combined with the high growth rates that are expected in mortgage loans and overdraft facilities, it is expected that its loan losses to total loans will grow slightly. From this Nordea Poland's net loan loss is expected to increase with 30% in 2011, 25% in 2012 and 15% in 2010. Hereafter, the loan losses will stabilise at constant growth rate of 10%.

5.3.4 Income Tax expense

Nordea Poland's income tax expense has fluctuated reasonably during the last years. The effective tax rate has been ranging between 16-26% and is very much depended on adjustments of taxes from previous years as well as deferred taxes. The tax rate for companies in Poland has been flat at 19% during the last years. The tax rate used in this thesis is 22% since this is the average effective tax rate of the Nordea Poland for the years analysed.

5.3.5 Total Net Income

Nordea Poland's total net income is obtained from of all the forecasts made above and illustrated in the table below. The bank's net income is expected to increase rapidly in the first 3-4 years where after it is expected to increase by a constant growth rate until the end of the forecasting period.

	Explicit Forecast			Simplified Forecast						
Income statement (in tPLN)	**2011E**	**2012E**	**2013E**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Total operating income	**1.010.468**	**1.291.908**	**1.621.280**	**1.968.095**	**2.134.332**	**2.315.707**	**2.513.659**	**2.729.765**	**2.965.756**	**3.223.534**
changes y/y	28%	28%	25%	21%	8%	8%	9%	9%	9%	9%
Total operating expenses	**- 523.705**	**- 635.337**	**- 742.543**	**- 814.597**	**- 893.748**	**- 980.698**	**- 1.076.221**	**- 1.181.170**	**- 1.296.480**	**- 1.423.180**
changes y/y	19%	21%	17%	10%	10%	10%	10%	10%	10%	10%
Net loan losses	**- 26.819**	**- 33.524**	**- 38.552**	**- 42.408**	**- 46.648**	**- 51.313**	**- 56.444**	**- 62.089**	**- 68.298**	**- 75.128**
changes y/y	30%	25%	15%	10%	10%	10%	10%	10%	10%	10%
Income tax expense	**- 101.188**	**- 137.070**	**- 184.841**	**- 244.440**	**- 262.666**	**- 282.413**	**- 303.819**	**- 327.031**	**- 352.215**	**- 379.550**
changes y/y	50%	35%	35%	32%	7%	8%	8%	8%	8%	8%
Net profit of the year	**358.756**	**485.977**	**655.344**	**866.650**	**931.270**	**1.001.283**	**1.077.175**	**1.159.474**	**1.248.763**	**1.345.676**
changes y/y	38%	35%	35%	32%	7%	8%	8%	8%	8%	8%

Source: Own estimation

5.3.6 Total Capital Requirement

As illustrated earlier it is estimated that Nordea Poland will be able to grow its loan portfolio massively through the next years. This, together with the fact that there has been a change in capital requirement through new capital regulations (Basel III rules), means that the bank is required to strengthen its capital base considerably.

As it was pointed out in the financial analysis the majority of the bank's capital requirements is connected to its RWA from its loan portfolio and the subsequent credit risk. Only a very limited capital requirement with respect to its operational risk, had on influence on the total requirement. The capital requirement for credit risk will be calculated using the expected increase in the loan portfolio and the estimated average risk weight to find the RWA and the subsequent credit risk (see appendix 15.4 for a summery of the total capital requirement). The average risk weight has been found to be 0,63 in 2009[128]. In 2010 and 2011 the average risk weight is expected to be a little higher given the fact that most of Nordea Poland's increase in loan portfolio comes from an increase in mortgages loans. In the years 2012 and 2013 it is expected that the average risk weight will fall to 0,63 again and in the long run the weight is considered to be 0,60. This development has been chosen since it is expected that the housing market in Poland will stabilise in the long run.

The remaining capital requirements the bank currently has to comply with comes from its operational risk and this will thus build the ground for forecasts of the total other capital requirements. Given that the banks scope of business will increase largely in the next years a constant growth rate of 20% in the other capital requirement will be used[129]. This level is found sufficient and capable of covering other capital requirements, that could arise following others risk than those touched upon here.

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[128] Information on the average risk weight for 2010 is not yet available and thus the figure from 2009 will be the basis for future risk weights. The average risk weight is calculated by dividing the RWA by the total loan portfolio in 2009.

[129] Information of the total other capital requirement is from 2009.

5.3.7 Total changes in Equity

With respect to changes in the banks equity, Nordea Poland has, historically seen used two sources capital to strengthen its capital position. First, Nordea Poland has only paid out a very limited amount of dividends to equity holders and has in the majority of years retained its earning into the equity of the bank. Furthermore, the bank has increasingly made use of the capital available in the mother company by issuing new shares.

Going forward it is expected that the bank will be continuing to retain all its earnings to be able to meet the increased total capital requirement the bank will be facing from its massive organic growth. Other sources of equity are considered to be used only under special circumstances and are thus not included in the valuation of the bank. These could for instance be another share capital increase or issuance of subordinated debt issue. In general, it is estimated that Nordea Poland's future retained earnings will be sufficient to meet the banks future capital requirement.

5.3.8 Other Comprehensive Income

Nordea Poland has historically not reported any other compressive income net of tax and thus the future income in connection to this is forecasted to be null. In case Nordea Poland would start reporting other comprehensive incomes in the future, these are expected to be very limited and would therefore only have a minor effect on the valuation carried out.

6. Valuation

In order to determine the value of Nordea Poland the forecasted figures from the previous section will be used. The model used in the valuation is a modified cash flow to equity model.

6.1 Calculating the Cost of Equity

To start of with it would be rational to calculate the cost of equity. To calculate the cost of equity one requires the risk free rate of return, the market risk premium and the systematic risk of equity (beta).

6.1.1 Risk Free Rate of Return

In reality, the term risk free rate of return does not exist. Nevertheless, it is possible to use alternative approaches in order to get a very close approximation of the risk free rate of return. These alternatives include using the rate of a 10-year government bond and the rate of 30-year government bond. For several reasons, the best and most appropriate is to use the 10-year government bond. First of all, the maturity of this bond matches the duration of the future cash flows calculated in this valuation the best. Second, the 10-year rate approximates the duration of any given stock market index and its use thus reflects the most appropriate betas and risk premiums respectively. Lastly, the prices of bonds with shorter maturities are less sensitive to unexpected changes e.g. inflation[130].

[130] Copeland, Tom & Koller, Tim & Murrin, Jack. "Valuation: Measuring and Managing the Value of Companies"

This valuation will use an average of the 10-year Polish government bond. This has been found to be 7,08%[131].

6.1.2 Market Risk Premium

The market risk premium is the return investors expect to receive, if these were to invest in the market instead of the risk free rate. The market risk premium is one of the most complicated issues within finance and there are several methods for calculating this by either using historical data or by forecasting future risk premiums[132]. Many financial managers and economist believe that long-term historical returns are the best measures available. Aswath Damodaran recently published an overview of total market risk premiums for several individual countries based on a country's rating as well as the level of the current credit default swap (CDS). In this overview the market risk premium for Poland is found to be 6,5%[133]. A similar survey carried out recently on this matter, showed that the average market risk premium for Poland used by numerous analysts during 2010 was found to be around 5,1%[134]. One could argue that that a premium between 5,1% and 6,5% seems reasonably high. However, since the scope of the valuation covers a long-term period, and it is assumed that the financial sector will experience an economic upturn in the coming years, it seems these levels are appropriate. The market risk premium used in this thesis will be in the lower end of this range, due to the fact that Poland has started to behave more and more like European economies. In this thesis a market risk premium of 5,5% is used.

6.1.3 Systematic Risk of Equity

The systematic risk of equity (beta) shows the given equity's correlation measured in return compared to the market it operates in[135]. The best way to find the most appropriate beta value is to use public available information, which is published on a regular basis by a range of global research and analysis institutes (for example MSCI Barra or Bloomberg). When using betas, one should make sure that the given beta for a stock also reflects the corresponding industry beta. If the beta varies more than 0,3 it might be useful to use the beta of the industry or a group of peers.

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[131] Bloomberg
[132] Copeland, Tom & Koller, Tim & Murrin, Jack. "Valuation: Measuring and Managing the Value of Companies"
[133] Damodaran, Aswath. "Country Default Spreads and Risk Premiums"
[134] Fernández, Pablo & Campo, Javier. " Market Risk Premium used in by Analysts and Companies"
[135] Damodaran, Aswath. "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset"

Nordea Poland's historical betas have ranged from 0,4 and 0,5, when comparing to the main index in Poland[136]. Given the fact that Nordea Poland's share is traded in very limited volumes, it can be argued that a beta in this range does not reflect the real systematic risk of the share. Consequently, it appears to be more sound to use a beta that is based on the average of the peer group's beta values (including Nordea Poland) relative to the main market index in Poland. This results in a total beta of 0,95[137]

Recalling the formula for calculating cost of equity, the cost of equity is calculated as:

$$K_e = r_f + [E(r_m) - r_f] * \beta \rightarrow K_e = 7{,}08\% + 5{,}5\% * 0{,}95 = \underline{\underline{12{,}31\%}}$$

6.2 Calculating the Equity Value of Nordea Poland

To start the calculation of Nordea Poland's total equity, all the cash flows in year 1-10 are required. In the forecasting/budgeting section all the necessary information for calculating these were presented and the table below summarises the calculated cash flows. As can be observed the only two cash flows that will influence the total value of Nordea Poland are found in year 2011 and 2012. The reason as to why there are no remaining cash flows, is connected to the fact, that it is estimated the bank will retain of all the earnings made in the years until 2020. Furthermore, the reason to why these two cash flows are negative is due to the fact that the bank's capital requirement will grow more than its expected net income explainable by the massive organic growth the bank will undergo. As this has been known by the Nordea group for some time, the bank carried out a share capital increase during 2010 allowing for sufficient capital for the next couple of years.

136 Bloomberg
137 Calculated from an average daily Beta of the banks involved using Bloomberg

CFE - The model	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Net profit of the year	358.756	485.977	655.344	866.650	931.270	1.001.283	1.077.175	1.159.474	1.248.763	1.345.676	1.392.775
Changes in TCR	430.328	503.776	421.416	128.657	285.849	580.408	662.657	755.834	861.368	603.967	235.270
Changes in Equity	-	-	233.929	737.993	645.421	420.875	414.518	403.640	387.395	741.709	
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	-	-	
CFE	- 71.572	- 17.800	-	-	-	-	-	-	-	-	1.157.505

Source: Own estimation

Turning to the calculating of the terminal value, a long-term growth rate as well as the expected return of equity (ROE) must be estimated. Considering the fact that inflation in Poland will be ranging from 2-2,5%, combined with the fact that Nordea Poland is expected to be performing considerably well going forward, a long term a growth rate of 3,5% will be used. Turning to the expected ROE, it can be noted that the average among banks in Poland has been relatively high throughout history[138] and thus it has been decided to use an expected ROE of 15%. The continuing value is then found using the formula introduced in the methodology section and discounted at the cost of equity.

$$CV = \frac{(NI_{t+1} - \Delta CR_{t+1})\ x \frac{g}{ROE})}{(K_e - g)} = \frac{1.157.505\ x \frac{3,5\%}{15\%})}{(12,31\% - 3,5\%)} = 10.078.595 \text{ tPLN}$$

Next step is to sum all the discounted cash flows as well as the discounted continuing value to get the total equity value of Nordea Poland. Once this is found, the value must be divided by the current amount of outstanding shares (amount outstanding on the 15th of February) to reach the theoretical share price of Nordea Poland. The final calculations of the valuation are shown in the table below.

[138] Based on the calculation made on the peer group.

Year		Cash flow to equity (CFE)	Discount factor	Present value of CFE
2011	1	- 71.572	0,8904	- 63.730
2012	2	- 17.800	0,7929	- 14.113
2013	3	-	0,7060	-
2014	4	-	0,6286	-
2015	5	-	0,5598	-
2016	6	-	0,4984	-
2017	7	-	0,4438	-
2018	8	-	0,3952	-
2019	9	-	0,3519	-
2020	10	-	0,3133	-
Continuing value		10.078.595	0,2790	2.811.965
Value of total equity (tPLN)				2.734.123
Outstanding Shares				55.499
Share price in PLN				**49,26**

Source: Own calculation

The valuation performed on Nordea Poland shows that the bank has a theoretical share price of PLN 49,26 at the end of 2010.

7. Evaluation of Results

Throughout the past Nordea Poland's share has been performing quite well in comparison to the performance of the average peer group as well as the average European bank. At the current state the share trades close to a 5-year high and has only limited effected by the financial crisis (see appendix 16 for a detailed illustration of Nordea Poland's share performance).

7.1 Current Share Price

To start of with, it would be essential to compare the calculated price with the corresponding price at which the share traded on the day of the valuation. Nordea Poland's share price was calculated to be PLN 49,26 at the end of 2010. At this date the share traded at PLN 40,10 and thus it seems the calculated price is somewhat higher than the traded price. Interesting is the fact share price from the start of the year until now has increased with 15%, where the peer group in Poland has been traded negative of 3%. Furthermore, at the date when the group Nordea AB published its annual report of 2010 (2^{nd} of February) the share price of Nordea Poland rallied with 8,5%. These two facts are somewhat clear signals that investors believe the share has a very large potential. However, one should note that Nordea Poland's current unstable situation increases the uncertainty of the future share price, since it is difficult to estimate by how much Nordea Poland will be able to grow.

7.2 Relative Valuation

Having valued Nordea Poland using a cash flow based model it is now the aim to compare the price of Nordea Poland relative to its peers by using a relative valuation. As mentioned in the methodology the relative valuation will by done by looking at the P/E ratio and the P/B ratio in comparison to the selected peers.

7.2.1 P/E Ratio

Turning to the price earnings ratio and recalling the formula for calculating it, Nordea Poland's P/E is calculated as the following:

$$\frac{P}{E} = \frac{40{,}1}{5{,}21} = 7{,}69$$

This shows that investors currently are willing to pay 7,69 PLN for every 1 PLN of earnings at Nordea Poland. The average P/E ratio of Nordea Poland for the last six years has been at 13,03[139] and thus the current level seems very low. When comparing Nordea Poland's ratio to the average P/E ratio of the peer group, the current price also seems reasonably undervalued.

	P/E (12m T.)	P/E (EOY)	P/B
Nordea Poland	8,84	7,69	1,20
PKO Bank Polski S.A.	17,86	n/a	2,29
Bank Pekao S.A.	17,34	n/a	2,20
BRE Bank S.A.	20,27	17,38	1,99
ING Bank Śląski S.A.	14,69	15,44	1,96
Bank Zachodni WBK S.A.	17,19	n/a	2,56
Nordea AB	12,80	12,35	1,39
Avg.	17,47	16,41	2,20

Source: Annual Reports 2010 & Bloomberg

In general, it seems that top banks in Poland trade at a P/E range of 17-20. Given that Nordea Poland should trade close to the average of its peer group (since these are the banks Nordea Poland desires to be compared with), the current price of the share should be in a range of 88-104 given its current earnings[140]. This seems very high in comparison to the calculated price as well as the current price and can be explained with the fact that Nordea Poland currently is not as large in terms of size and earnings as its selected peers are. Going forward, however, Nordea Poland is expected to reach a state, where these are its main competitors and thus these have been selected to be the bank's main peers. Another reason to why the current share price is below the calculated range can be related to the fact that Nordea Poland's current situation is very unstable making it

[139] Calculated using data from Bloomberg

[140] Calculated as 17-20 x 5,21 = 88-104. Since not all banks have a end of year P/E ratio of 2010 available the 12 month trailing P/E was used.

cumbersome to predict future growth and net income, which in turn is reflected in the investors willingness to invest in the share.

7.2.2 P/B Ratio

Turning to the price book ratio and the formula for calculating it, Nordea Poland's P/B ratio is calculated as the following[141]:

$$\frac{P}{B} = 1{,}20$$

This shows that Nordea Poland's share trades a little higher in comparison to its book value. However, given the fact that the number is very close to 1 it seems that investors are not willing to pay excessively more than what the book value of the bank is worth. Historically seen (the last six years), Nordea Poland has been trading at an average P/B of 1,18 and it seems that the current level is well reflected in the historical average. When comparing to the average peer group (see table in previous section) it seems that investors are willing to pay twice as much for the book value of the average peer group in comparison to what they are willing to pay for Nordea Poland. This again can be related to the fact that Nordea Poland can be hard to value given its current situation.

From the above it becomes clear that Nordea Poland generally is trading well below its peers. This can to a great degree be explained by the fact that the bank currently is not easily comparable to the selected peers given that it has not yet reached the same level of the size and earnings. Furthermore, since the bank currently is in a phase of rapid growth and increased uncertainty it can be very difficult to value it. However, once the bank has stabilised it will be possible to value the bank more accurately and the peer group will be a perfect benchmark in a relative valuation.

[141] The calculation has been done using approximation from the annual report combined with information provided by Bloomberg.

7.3 Sensitivity Analysis

The sensitivity analysis will be used to show how the calculated share price will develop, given that some of the core assumptions of the model are changed. There are several core assumptions to choose from when performing a sensitivity analysis, however in this thesis the most relevant for Nordea Poland have been chosen. Since the continuing value of the valuation represents majority of the value at Nordea Poland this is where the starting point of the sensitivity analysis will be.

To start of with the sensitivity of Nordea Poland's share is tested in regards to changes in the cost of equity and the long term-growth rate.

		Cost of Equity						
		10,81%	11,31%	11,81%	12,31%	12,81%	13,31%	13,81%
Long term growth	6,5%	75	64	55	47	41	36	32
	5,5%	72	62	54	48	42	37	33
	4,5%	70	61	54	48	43	39	35
	3,5%	69	62	55	49,26	44	40	36
	2,5%	69	62	56	50	45	41	37
	1,5%	70	63	57	52	47	43	39
	0,5%	71	64	58	53	48	44	40

Source: Own creation

From the table above is becomes clear that Nordea Poland's share is relatively sensitive towards changes in the cost of equity and the long term growth rate. The starting point was a cost of equity of 12,31% and a long-term growth rate of 3,5%. If the cost of equity is held constant and the growth rate is tested in the range between +/- 3%, the share price will move in a price range of 47-53. This shows that the share price is somewhat sensitive towards the long-term growth rate. On other hand, if the growth rate is held constant and the cost of equity is tested in a range of +/- 1,5%, the share price will move in a price range of 36-69. From this it becomes clear that the share price of Nordea Poland is very sensitive towards changes in the cost of equity. This can be explained by the fact that if the cost of equity falls the possible returns from investing in either the risk free rate or the market falls, which will naturally have an impact on the share price.

Following the high sensitivity towards cost of equity it was found interesting to test the model in respect to cost of equity and possible dividend payout. This was chosen as shareholders in general demand returns in form of price changes or in form of dividends. Furthermore, given the nature of the banks current strategy in Poland, it was found interesting to see how the share price would react if the bank would payout dividends.

		Cost of Equity						
		10,81%	11,31%	11,81%	12,31%	12,81%	13,31%	13,81%
Payout ratio	0%	69	62	55	49,26	44	40	36
	20%	77	69	62	56	51	46	42
	40%	84	76	69	63	58	53	49
	60%	92	83	76	70	64	59	55
	80%	99	91	83	77	71	66	61
	100%	107	98	90	84	78	73	68

Source: Own creation

From the table above is becomes evident that Nordea Poland's share is very sensitive towards changes in the cost of equity and the payout ratio. The starting point was a cost of equity of 12,31% and a payout ratio of 0%. To recall, the latter was chosen given the banks overall strategy and structure as well as large need for capital given its planned organic growth. If the cost of equity is held constant and the payout ratio is tested in the range between 0-100%, the share price will move in a price range of 49-84. When the payout ratio is held constant at 0% and the cost of equity is stressed in the range +/-1,5%, the share will move in the same range as illustrated above. However, and more interestingly, when holding none of the involved factors constant the share price can move in a range of 36-107. This clearly shows how sensitive the share is towards changes in the cost of equity combined with changes in the payout ratio. The reason behind this can be explained by the fact, that once the bank will pay out dividends to investors, the share will become more attractive and the price will rise as a consequence. However, one has to keep in mind that currently Nordea Poland is in a growth phase and is in a strong need for capital to do so and therefore the bank would not be able to pay the dividends. If the bank would pay out dividends the growth phase in the valuation would also look very different, and the share price would behave correspondingly.

7.3.1 Sensitivity Analysis - Valuation Disregarding Capital Requirements

In this thesis it has been underlined that capital requirements play a large role in how banks operate in today's business world. It would be interesting to see how the price of the share would react, if the valuation of Nordea Poland would have been carried out without having included the future capital requirement. Briefly adjusting the model to exclude the capital requirement calculations, yields the following cash flows to equity when holding the reaming assumptions constant:

CFE - The model	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E
Net profit of the year	358.756	485.977	655.344	866.650	931.270	1.001.283	1.077.175	1.159.474	1.248.763	1.345.676	1.392.775
Changes in TCR	-	-	-	-	-	-	-	-	-	-	-
Changes in Equity	358.756	485.977	655.344	866.650	931.270	1.001.283	1.077.175	1.159.474	1.248.763	1.345.676	
Other comprehensive income, net of tax	-	-	-	-	-	-	-	-	-	-	
CFE	-	-	-	-	-	-	-	-	-	-	1.392.775

Source: Own creation

Calculating the continuing value with the same expected long term growth rate and the same expected return on equity yields the following continuing value:

$$CV = \frac{(NI_{t+1} - \Delta CR_{t+1})\, x \frac{g}{ROE})}{(K_e - g)} = \frac{1.157.505\, x \frac{3,5\%}{15\%})}{(12,31\% - 3,5\%)} = 12.127.131 \text{ tPLN}$$

Carrying out the final calculations of the valuation one gets a theoretical share price of 60,97 PLN (see table below). The valuation of Nordea Poland without the calculation of the capital requirements makes the share close to 24% higher, than the price in the initial valuation and shows that the share is very sensitive to the minimum capital requirement the bank is subject to.

Year		Cash flow to equity (CFE)	Discount factor	Present value of CFE
2011	1	-	0,8904	-
2012	2	-	0,7929	-
2013	3	-	0,7060	-
2014	4	-	0,6286	-
2015	5	-	0,5598	-
2016	6	-	0,4984	-
2017	7	-	0,4438	-
2018	8	-	0,3952	-
2019	9	-	0,3519	-
2020	10	-	0,3133	-
Continuing value		12.127.131	0,2790	3.383.515
Value of total equity (tPLN)				3.383.515
Outstanding Shares				55.499
Share price in PLN				**60,97**

Source: Own creation

It could be argued that, given that Nordea Poland retains all it earnings in both valuation cases, the calculation of capital requirement is pointless, since the bank has access to the same amount of capital in both cases. However, this is not correct.

In general, when companies retain earnings investors assume that the capital is used to carry out investments that will make the company grow and thus create long-term shareholder value. However, given that banks are subject to capital requirements, they are forced to put capital aside and therefore become restricted in the amount of capital to make use of. This will in the long run limit the growth of the bank as well as limit the long term share holder value. This will eventually have an effect on the share price of the bank, which is clearly illustrated by the difference in the two valuations carried out.

7.4 Recommendation

The initial valuation of the share would eventually result in a buy recommendation of the share, since the upside from the current price at 40,1 would be close to 23%. However, keeping the substantial increase of the share during the current year in mind, this recommendation would move towards a more neutral recommendation, where the upside lies at around 7%.

8. Conclusion

In this thesis a strategic and financial analysis was performed to budget and forecast the future growth and income potential of Nordea Poland. This information was used to perform a valuation of the bank and to assess the investment potential of the current share.

Following the recent transformation from communism and joining the European Union, Poland has experienced immense changes in its macro environment, specifically affecting the economy. Poland's GDP figures have been among the highest in Europe in recent years and the outlook for the economy is strong. Issues such as consumer spending and foreign direct investments have been the main drivers of the economy. Furthermore, the country has experienced a dramatic increase in its social standards and its labour conditions and the population of Poland is currently feeling the effects of this. The country, however, is still influenced by the consequences of the communism, where the inefficient government, bureaucracy as well as the high level of corruption have left their marks on the country.

The banking sector in Poland has also felt the recent development of the country and is currently in a state of rapid development. During the last decade, the sector has experienced a large increase in the level of competition following the inflow of foreign banks. The sector has become increasingly westernised and banks are offering products that customers in Poland did not have access to a few years ago. Demand for lending in the country is increasing and people today are using banking services more and more.

Nordea Poland's current market share in Poland is very limited and the bank only has around 2,5% of the total assets in the banking sector. However, the bank has only been operating in the country for a little more than two decades and is therefore still in a developing phase. The potential for Nordea Poland is huge and the bank's financial performance in the recent years has been impressive. The bank's net income has during the last six years increased by 7,5 times compared to the net income that the bank reported in 2005. In 2010 the bank was able to grow its net income by as much as 79%. The bank has also been increasing its credit portfolio dramatically during recent years, where total loans have increased with close to 4 times since 2005. The reason for this immense growth is Nordea Poland's overall approach to the banking business in the country.

The bank has been able to transfer its core concept of banking from the mother company to the subsidiary in Poland, where the focus largely evolves around the customer and offering of superior service. Drawing on the synergies of this, Nordea Poland has been able to differentiate itself and thus attracted the desired customers needed to achieve the overall goal of organic growth. The only threat that Nordea Poland currently faces is the banks increasing loan losses following a great exposure towards the housing market in Poland. The current state of the housing market in Poland is categorised by a downward trend in prices due to an oversupply. However, the housing market in Poland is expected to catch up at some point and Nordea Poland will in the long run be able to limit losses in connection to this.

In this thesis is has been estimated that the current tendency observed at Nordea Poland will continue going forward. Especially in the short run, where the bank is forecasted to increase its net income by as much 2,5 times in the next four years compared to the net income in 2010. However, given that the bank's growth is achieved solely through organic growth the long-term shareholder value is somewhat limited given the view of the minimum capital requirements the bank is subject to following the new Basel III rules. Evidentially, this has an effect on the share price of the bank, which was illustrated in the sensitivity analysis.

Going through the valuation of Nordea Poland by using a modified cash flow to equity model the theoretical share price on the 31st of December was found to be PLN 49,26. At the same time the share of Nordea Poland traded at a level of PLN 40,10 and it would appear that the share is undervalued. However, the share price has in the current year already increased with as much as 15%, illustrating that investors were able to draw similar conclusions in the beginning of the year.

Looking at Nordea Poland's share price in comparison to its main competitors, its appears that the price is very cheap. This is greatly related to the fact that Nordea Poland has not reached a stable position on the market in Poland and therefore is hardly comparable to any other bank in the country. When looking at the sensitivity of the share, it seems that Nordea Poland is most sensitive to changes in cost of equity, given that the banks behaves in the same manner as it has done previously. Changes in underlying assumptions such as payout ratio or capital requirement will have a great impact on the share price.

Referring back to the research questions lined out in the methodology of this thesis the following can be concluded:

The current theoretical share price of Nordea Poland is PLN 49,26. The share currently trades at PLN 40,10 (at the 31st of December) and thus it seems the market price is currently undervalued .

8.1 A Note on Future Research

Going through the valuation of Nordea Poland using an altered valuation model, it was found that capital requirements can have a great impact on the final result of the valuation. This was especially shown by the deviation between share price of the initial valuation and the share price of the valuation that did not include any form of capital requirement. Considering that banks are increasingly challenged by new financial rules and regulation it seems vital that valuations of financial institution include any form of calculation of capital requirement to reflect the present time of the financial world. The current research on this matter seems very limited and thus can be subject to future research. Given the increased focus that capital requirements have in today's financial sector, especially following the financial crisis, it seems there is strong need for valuation methods that increasingly take the capital requirements into account.

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Appendices

Appendix 1: The Four Factors Compromising a Valuation Model

Thomas Plenborg[142] looks at four different factors when comparing valuation models. Even though these factors are not the only ones defining the perfect valuation model they are somewhat a guideline to important elements of any given model. Two of the fundamental factors involve the precision of the model and how realistic the underlying assumptions of the model are. The two other factors (also called cosmetic factors) relate to how user friendly the model is and how easy it is to understand the final outcome of the valuation.

In respect to the precision of the model Plenborg argues that the better the model is in giving a more precise estimate of the value of the firm, given that the inputs of the model in question are forecasted correctly, the better the model will be. In respect to the underlying assumptions of the model he argues that the more realistic these are the more appropriate the model will be. In case these are more or less inaccurate the final estimate will be systematically wrong. When looking at the two cosmetic factors Plenborg argues that the more user friendly the model is, the easier and more likely one will end up with the desired out come and vice versa. Finally it is important that the final value estimate is easy to interpret. The easier the outcome is to interpret the better the user of the model will be in taking the best action in accordance with this value estimate.

[142] Plenborg, Thomas. ”Valg af (ideel) værdiansættelsesmodel”

Appendix 2: Aswath Damodaran's Three Valuation Models

Aswath Damodaran[143] uses three core valuation models. These are the discounted cash flow model, the relative valuation model and the contingent claim model. These will shortly be elaborated on below.

The discounted cash flow model relates the value of an asset to the present value of an expected future cash flow to that given asset. There are two ways of approaching the discounted cash flow valuation. First, one can value only the equity stake in the firm. This involves discounting expected cash flows to equity at the cost of equity that is required by the investors in the firm. The cash flow to equity is the amount that the company could pay out to investors and covers the residual cash flow after meeting all expenses and obligations. An alternative approach in equity valuations is the dividend discount model that focuses on the expected future dividend rather than on residual cash flows. The second type of valuation using the discounted cash flow model is doing a valuation of the entire firm. In this type the residual cash flow is discounted at the weighted average return of capital (WACC). Furthermore the residual cash flow includes only the cash flow after meeting operating expenses (including taxes) and not prior to meeting debt obligations. The two main differences between the two discounted cash flow models are the difference of treating debt in the cash flow of the model and the rate at which the cash flows are discounted. The key to using the discounted flow models successfully is to be able to estimate future cash flows correctly and reliably and to be able to find the proxy of risk that best fits the rate at which the cash flows should be discounted[144].

The relative valuation model values an asset from pricing comparable assets using a common variable (multiple) such as earnings, cash flows, book values or revenues. There are two means of comparison when using multiples. Either the valuation can be done by comparing an industry-average multiple to the firm or by using a multiple from a set of selected peer firms (or a single firm) in comparison to the firm. Furthermore there are two ways of finding the appropriate

[143] Damodaran, Aswath. "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset"

[144] Damodaran, Aswath. "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset"

multiple. The first approach relates the multiples to fundamentals of the firm being valued. This covers growth rates in earnings and cash flows, payout ratios and risks. This approach is identical to the discounted cash flow models since it requires the same information and estimations. The other approach involves using selected static variables that best explain the industry average or a set of peer firms. The most used multiples are the price/earnings ratio, the price/book ratio and the price/sales ratio. The relative approach is in most cases simple and easy to use especially when comparing to a large number of comparable firms. However, given the fact that it is easy to use the approach is also easily misused in the since that it is hard to find the right comparables as well as it can be easy to extract variables that are not easily comparable.

The contingent claim valuation is used when valuing assets that only pay off under certain circumstances. It uses option pricing models to find the value of an asset that have similar characteristics as options. For instance, a value of an asset can be valued with a call option when it exceeds a prespecified value and can be valued with a put option when it gets below a prespecified value[145]. The value of the option can be found using the Black and Scholes model that was first derived in 1972[146]. This approach can be very complex and is used only on certain types of asset.

The above models are the three core valuation models used throughout theory as well as in practise and there should be a place for all of them in today's financial business world. The importance when carrying out a valuation does not entirely rely on choosing the right model to use but also and more importantly on the input factors that form the final result[147].

[145] Damodaran, Aswath. "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset"

[146] Black, Fisher & Scholes, Myron. "The Pricing of Options and Corporate Liabilities"

[147] Damodaran, Aswath. "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset"

Appendix 3: Basel III Rules

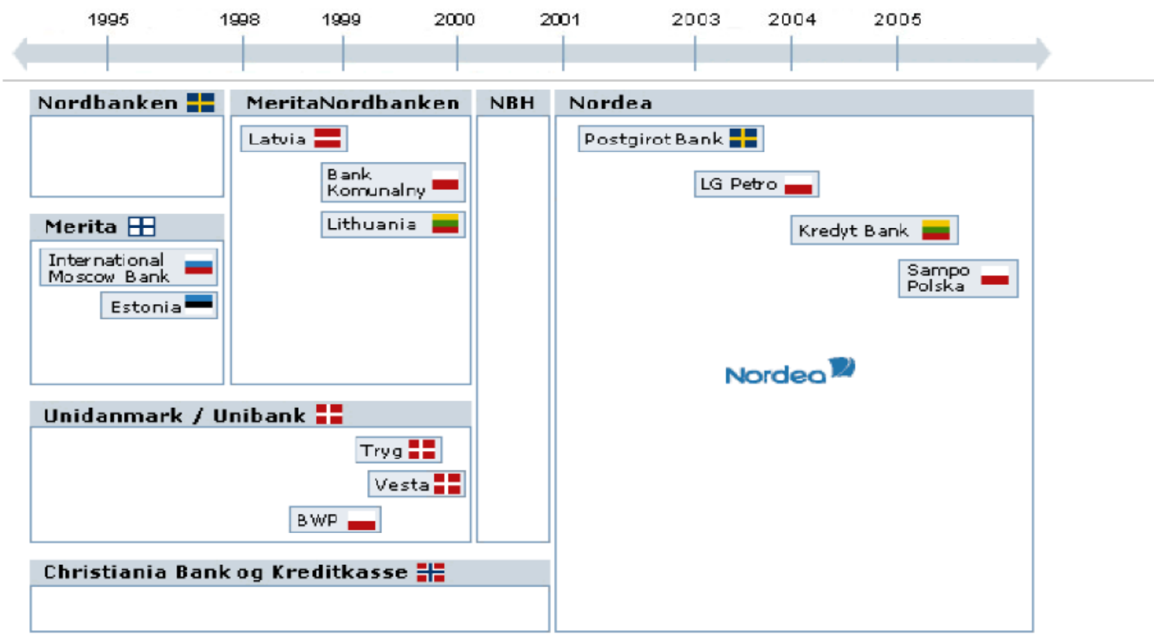
	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 January 2019
Leverage Ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
Minimum Common Equity Capital Ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.50%
Minimum common equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%

Source: BIS

Appendix 4: History of Nordea AB

The complete Nordea Group was formed in 2001 and is a result of the merger between several Nordic banks that took place from 1997 to 2001. The merging companies go back to where it all started in 1820. A saying goes that one of the first customers was the famous Danish writer H.C. Andersen when he was a client in the Sparekassen for Kjøbenhavn og Omegn.

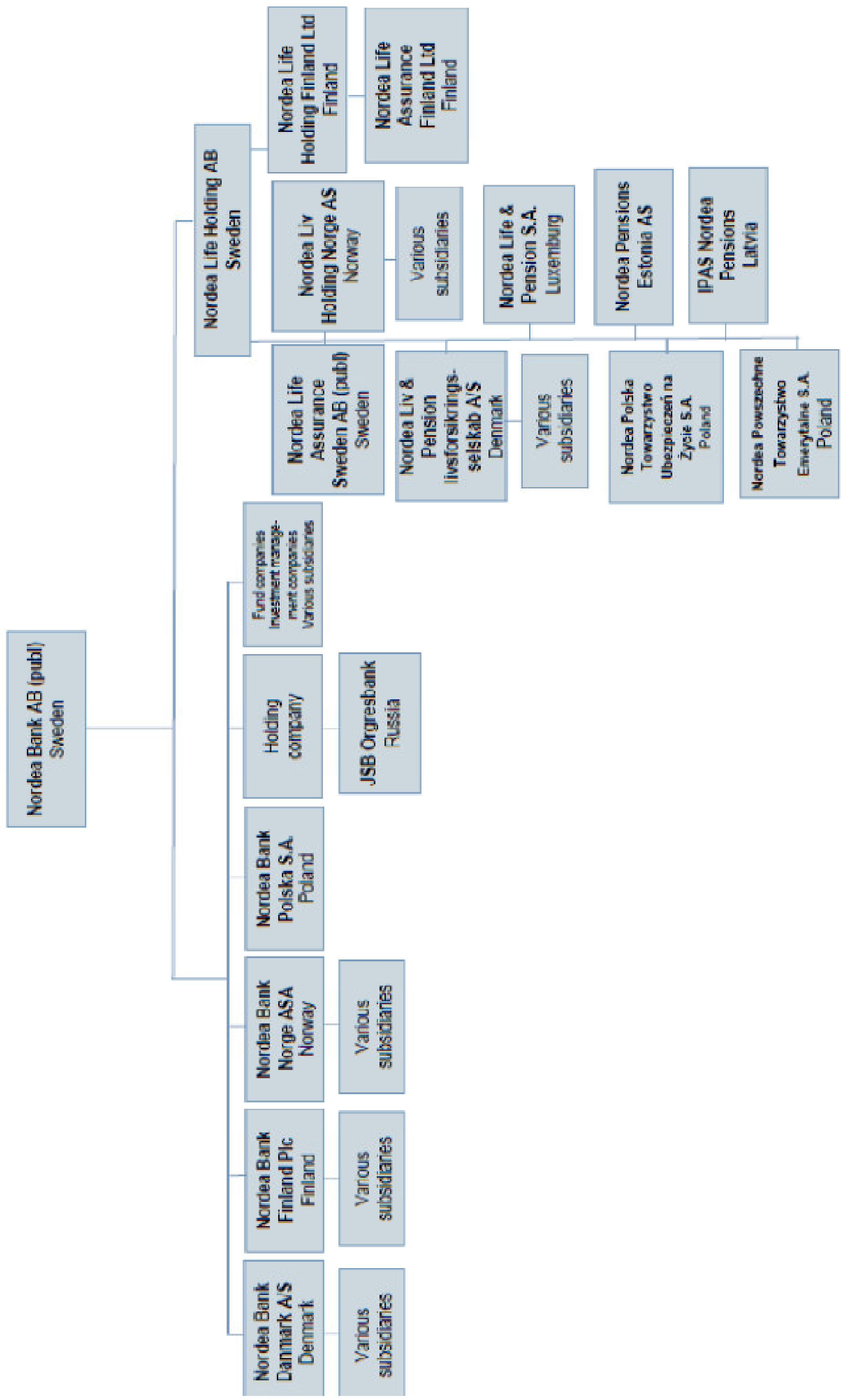
The chart below gives the reader a good understanding of how the group was formed. The stating point was the merger between the Swedish Nordbanken and the Finnish Merita Bank that took place in 1997 and created the MeraitaNordbanken. Next was the merger between MeraitaNordbanken and Unidanmark/Unibank that took place in 2000 and created the Nordic Baltic Holding Group (NBH). Unibank is the part of the Nordea Group that had it roost back to the 1820's. The final merger that initially created the group at the end of 2000 was the merger between NBH and the Norwegian bank Christiania Bank and Kreditkasse (Nordea, 2010).



Source: Nordea AB website

The group was formed at the end of 2000; however it was not until the end of December 2001 that all operations within this group were conducted under the brand name Nordea. The name is derived from the words *Nordic* and *Idea* and the groups mission is to help achieve what they aspire for, i.e. "making it possible".

Appendix 5: Organisational Chart of the Nordea Group



Source: Nordea Annual Report 2010

Appendix 6: The Products of Nordea AB

Nordea AB's product range includes account products, transaction products, financing products, capital market products, savings & assets management products and life & pension products[148].

The accounts products include lending, deposits, cards and private net banking. The transaction products include cash management, trade & project financing and securities services. The capital markets products are involved around risk management products. The savings & assets management products include a variety of products all dependent on demand and risk appetite of the customers as well as on the pressures from macro economic environment. The life & pension products offer a variety of products within the life insurance and retirement pensions industry. Nordea AB has strengthens its product offerings through launches of several new products and concepts during 2009/10 and this has also had an effect on the bank in Poland.

[148] Nordea AB Annual Report 2010

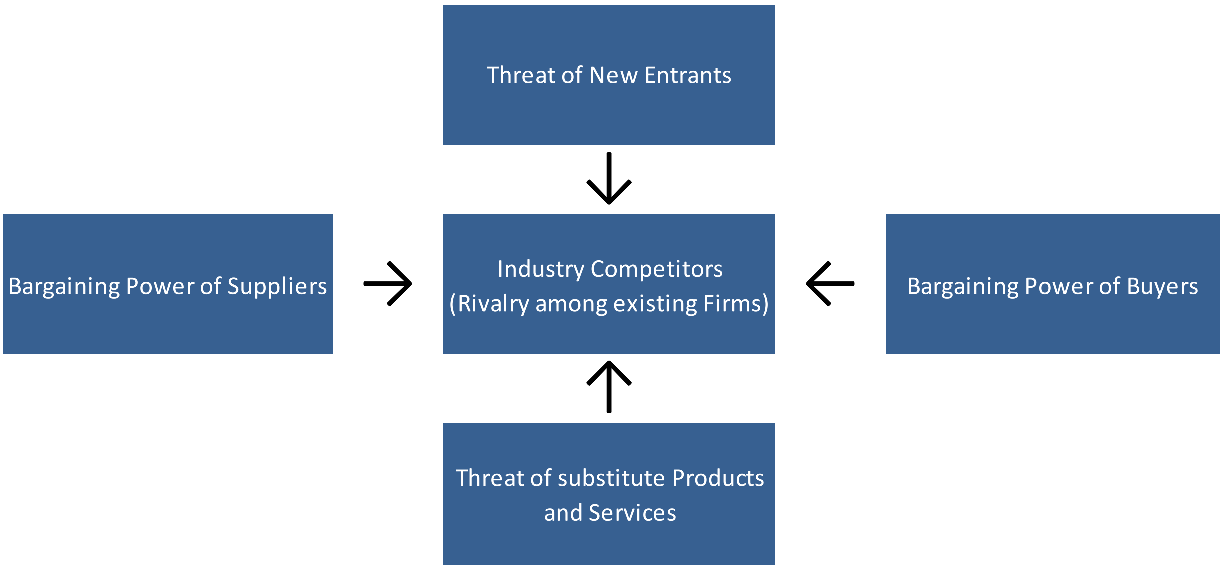
Appendix 7: PEST Analysis – A Summary

+	-
Political factors:	
Recent transformation (incl. EU)	Government bureaucracy
Globalisation (Finance)	Tax regulations
FDI	Corruption
Fiscal and monetary stimulus	
Economical factors:	
GDP growth	Budget deficit
Free floating exchange rate	Domino effect
Limited inflationary pressures	High energy prices
Downward trend in unemployment	Housing prices (foreign loans)
Consumer Spending	Free floating exchange rate
Social factors:	
Increasing HDI Index	High unemployment
Median Household income	Low healthcare spending
Technological factors:	
Strong mobile phone industry	Lack of IT professionals
	High regulation in the sector

Source: Own Creation

Appendix 8: Porter's Five Forces

Appendix 8.1: The Model



Source: Own creation inspired by M. Porter (1980)

Appendix 8.2: Porter's Five Forces – A Summary

Low Threats/High barriers	High Threats/Low barriers
Industry Competitors: Large amount of banks Low Herfindal Index	
Threats of New Entrants: Lending activity requires capital (hard to access and costly) High start up burdens (+ cost)	Offering financial services is cheap Industrial companies
Threats from Substitutes Products or Services:	Consumers demand simple products The change in corporate lending
Bargaining power of suppliers: Capital (during economic downturn)	Capital (during economic upturn)
Bargaining power of buyers High switching costs	Freedom of choice

Source: Own Creation

Appendix 9: SWOT - A Summary

Strengths	Weaknesses
A transparent banking model Solid capital base (mother company) A service minded bank Reward winning E-Banking A safe bank	Organic growth (costly) Universal bank focus (short term) High exposure to housing market Funding structure
Opportunities	**Threats**
Increasing demand for consumer credit High consumer spending Lower than average net interest margins Access to cheap well educated labour	General instability in Poland Intense competition Lack of IT professionals Regulation and bureaucracy Basel III Accord Increasing loan losses

Source: Own Creation

Appendix 10: Income Statements 2005-2010

	Historical					
Income statement (in tPLN)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Exchange rate - End of year - 1 EUR	3,8598	3,8312	3,5820	4,1724	4,1082	3,9603
Exchange rate - End of year - 1 DKK	0,5174	0,5139	0,4803	0,5599	0,5520	0,5313
	Historical					
Operating income	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Net interest income	127.254	135.346	175.455	300.072	352.579	461.910
Net fee and commission income	35.590	45.406	57.355	56.514	69.174	91.012
Net gain/losses on items at fair value	39.410	56.802	84.730	118.357	153.006	201.625
Other operating income	15.735	8.143	10.866	12.185	18.630	34.164
Total operating income	**217.989**	**245.697**	**328.406**	**487.128**	**593.389**	**788.711**
						33%
	Historical					
Operating expenses	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
General administrative expenses:						
- Staff costs	- 66.508	- 77.527	- 101.481	- 134.663	- 169.216	- 188.581
- Other expenses	- 83.232	- 81.350	- 110.728	- 149.281	- 181.732	- 214.591
Depreciation, amortisation and impairment charges of tangible and intangible assets	- 29.176	- 24.309	- 21.821	- 23.861	- 32.759	- 37.999
Total operating expenses	**- 178.916**	**- 183.186**	**- 234.030**	**- 307.805**	**- 383.707**	**- 441.171**
Profit before loan losses	**39.073**	**62.511**	**94.376**	**179.323**	**209.682**	**347.540**
Net loan losses -2673	- 2.492	5.416	- 3.842	- 2.108	- 16.718	- 20.630
Operating profit	**36.581**	**67.927**	**90.534**	**177.215**	**192.964**	**326.910**
Income tax expense	- 5.854	- 17.859	- 20.002	- 40.795	- 47.771	- 67.573
Net profit of the year	**30.727**	**50.068**	**70.532**	**136.420**	**145.193**	**259.337**

Source: Annual Reports 2005-2010

Appendix 11: Balance Sheets 2005-2010

Balance Sheet (In tPLN)	Historical 2005	2006	2007	2008	2009	2010
Exchange rate - End of year - EUR	3,8598	3,8312	3,5820	4,1724	4,1082	3,9603
Exchange rate - End of year - DKK	0,5174	0,5139	0,4803	0,5599	0,5520	0,5313
Assets						
Cash and balances with central bank	114.050	131.738	471.000	214.139	652.036	628.834
Loans and advances to banks	956.007	681.680	269.280	201.265	497.251	839.607
Loans and advances to customers	4.018.498	5.335.933	8.635.834	13.676.132	16.996.797	20.718.093
Financial assets at fair value	654.673	562.101	599.208	1.263.532	1.901.570	2.240.282
Intangible Assets	54.338	44.014	41.212	44.131	44.740	44.689
Property, plant and equipment	54.828	56.264	76.380	136.795	138.380	158.217
Deferred tax assets, net	33.951	23.971	27.325	25.833	31.565	43.763
Other assets	32.971	82.447	119.209	185.559	162.631	158.881
Total assets	**5.919.316**	**6.918.148**	**10.239.448**	**15.747.386**	**20.424.970**	**24.832.366**
Liabilities						
Deposits from banks	1.582.653	1.383.171	2.681.226	5.853.468	9.411.662	12.566.105
Deposits from customers	3.733.389	4.799.915	6.334.684	8.386.504	9.252.451	9.460.672
Liabilities from debt securities issued	2.225	1.824	1.501	1.317	-	325.139
Financial liabilities at fair value	13.583	13.177	14.521	92.572	33.646	19.587
Other liabilities	49.948	139.153	105.665	121.345	103.856	141.811
Subordinated liabilities	-	-	171.303	221.873	408.780	467.314
Reserves	20.427	13.749	9.703	10.324	9.087	373
Total liabilities	**5.402.225**	**6.350.989**	**9.318.603**	**14.687.403**	**19.219.482**	**22.981.001**
Share capital	168.089	168.089	227.089	227.594	227.594	277.494
Other reserve capital	318.275	349.002	623.224	695.969	832.701	1.314.534
Profit for the year	30.727	50.068	70.532	136.420	145.193	259.337
Total shareholder equity	**517.091**	**567.159**	**920.845**	**1.059.983**	**1.205.488**	**1.851.365**
Total liabilities and equity	**5.919.316**	**6.918.148**	**10.239.448**	**15.747.386**	**20.424.970**	**24.832.366**

Source: Annual Reports 2005-2010

Appendix 12: Peer Group Figures

Appendix 12.1: Net Income

Net Income (in mPLN)	2005	2006	2007	2008	2009	2010
Nordea Poland	31	50	71	136	145	259
PKO Bank Polski S.A.	1.735	2.149	2.904	3.121	2.306	n/a
Bank Pekao S.A.	1.538	1.788	2.155	3.528	2.412	n/a
BRE Bank S.A.	248	421	710	857	129	642
ING Bank Śląski S.A.	549	591	631	445	595	753
Bank Zachodni WBK S.A.	516	758	954	855	886	n/a
Nordea AB (in mEUR)	2.263	3.145	3.121	2.671	2.314	2.657
Avg. peer	917	1.141	1.471	1.761	1.265	697

Source: Annual Reports 2005-2010 & Bloomberg

Appendix 12.2: Net Income changes y/y

Net Income changes y/y	2006	2007	2008	2009	2010
Nordea Poland	63%	41%	93%	6%	79%
PKO Bank Polski S.A.	24%	35%	7%	-26%	n/a
Bank Pekao S.A.	16%	21%	64%	-32%	n/a
BRE Bank S.A.	70%	69%	21%	-85%	398%
ING Bank Śląski S.A.	8%	7%	-29%	34%	27%
Bank Zachodni WBK S.A.	47%	26%	-10%	4%	n/a
Nordea AB (in mEUR)	39%	-1%	-14%	-13%	15%
Avg. peer	33%	31%	10%	-21%	212%

Source: Annual Reports 2005-2010 & Bloomberg

Appendix 12.3: Performance Indicators

ROA (in %)	2005	2006	2007	2008	2009	2010
Nordea Poland	0,72	0,52	0,69	1,05	0,80	1,15
PKO Bank Polski S.A.	1,86	2,15	2,67	3,03	1,64	n/a
Bank Pekao S.A.	2,62	2,64	2,95	2,72	1,88	n/a
BRE Bank S.A.	0,76	0,96	1,47	1,35	0,25	0,94
ING Bank Śląski S.A.	1,30	1,23	1,27	0,89	0,94	1,12
Bank Zachodni WBK S.A.	1,88	2,29	2,78	2,12	1,38	n/a
Nordea AB	0,70	0,84	0,85	0,65	0,50	0,49
Avg. peer	1,68	1,85	2,23	2,02	1,22	1,03

Source: Annual Reports 2005-2010 & Bloomberg

ROE (in %)	2005	2006	2007	2008	2009	2010
Nordea Poland	5,98	9,24	9,48	13,77	12,82	19,60
PKO Bank Polski S.A.	19,80	22,85	26,40	24,12	13,41	n/a
Bank Pekao S.A.	18,74	20,68	18,31	23,05	14,09	n/a
BRE Bank S.A.	12,70	18,45	24,25	23,76	3,22	11,52
ING Bank Śląski S.A.	16,38	16,19	16,61	11,05	13,07	14,35
Bank Zachodni WBK S.A.	16,13	20,66	23,00	18,37	16,23	n/a
Nordea AB	17,03	20,54	19,46	15,13	11,86	11,38
Avg. peer	16,75	19,77	21,71	20,07	12,00	12,94

Source: Annual Reports 2005-2010 & Bloomberg

EPS (in PLN)	2005	2006	2007	2008	2009	2010
Nordea Poland	0,91	1,49	1,55	3,00	3,19	5,21
PKO Bank Polski S.A.	1,60	1,98	2,68	2,88	2,06	n/a
Bank Pekao S.A.	9,24	10,72	12,17	12,11	9,20	n/a
BRE Bank S.A.	7,59	11,59	18,61	21,62	3,83	17,49
ING Bank Śląski S.A.	42,23	45,45	48,48	34,24	45,74	60,22
Bank Zachodni WBK S.A.	7,08	10,39	13,09	11,72	12,13	n/a
Nordea AB (EUR)	0,68	0,96	0,96	0,82	0,60	0,60
Avg. peer	13,55	16,03	19,01	16,51	14,59	38,86

Source: Annual Reports 2005-2010 & Bloomberg

Appendix 12.4 Total Loans & Loan Losses

Loan Losses (in mPLN)	2005	2006	2007	2008	2009	2010
Nordea Poland	3	-5	4	2	17	21
PKO Bank Polski S.A.	61	2	57	1.130	1.681	n/a
Bank Pekao S.A.	237	129	161	349	571	n/a
BRE Bank S.A.	79	46	72	256	1.108	687
ING Bank Śląski S.A.	-106	-159	-106	80	293	204
Bank Zachodni WBK S.A.	55	28	33	358	478	n/a
Nordea AB (in mEUR)	-137	-257	-60	466	1.486	879
Avg. peer	65	9	43	435	826	446

Source: Annual Reports 2005-2010 & Bloomberg

Total loans (in mPLN)	2005	2006	2007	2008	2009	2010
Nordea Poland	4.184	5.432	8.636	13.750	17.074	20.813
PKO Bank Polski S.A.	49.862	61.449	78.833	104.026	120.510	n/a
Bank Pekao S.A.	33.364	36.575	74.557	86.629	83.677	n/a
BRE Bank S.A.	16.327	23.882	34.365	53.002	54.434	61.820
ING Bank Śląski S.A.	10.708	13.691	16.379	26.245	30.847	34.590
Bank Zachodni WBK S.A.	14.924	17.607	23.950	35.585	35.700	n/a
Nordea AB (in mEUR)	189.941	215.084	245.629	266.247	284.529	316.709
Avg. peer	25.037	30.641	45.617	61.097	65.034	48.205

Source: Annual Reports 2005-2010 & Bloomberg

Total loans changes y/y	2006	2007	2008	2009	2010
Nordea Poland	30%	59%	59%	24%	22%
PKO Bank Polski S.A.	23%	28%	32%	16%	n/a
Bank Pekao S.A.	10%	104%	16%	-3%	n/a
BRE Bank S.A.	46%	44%	54%	3%	14%
ING Bank Śląski S.A.	28%	20%	60%	18%	12%
Bank Zachodni WBK S.A.	18%	36%	49%	0%	n/a
Nordea AB	13%	14%	8%	7%	11%
Avg. peer	25%	46%	42%	7%	13%

Source: Annual Reports 2005-2010 & Bloomberg

Loan Losses/Total loans	2005	2006	2007	2008	2009	2010
Nordea Poland	0,07%	-0,08%	0,04%	0,02%	0,10%	0,10%
PKO Bank Polski S.A.	0,12%	0,00%	0,07%	1,09%	1,39%	n/a
Bank Pekao S.A.	0,71%	0,35%	0,22%	0,40%	0,68%	n/a
BRE Bank S.A.	0,48%	0,19%	0,21%	0,48%	2,04%	1,11%
ING Bank Śląski S.A.	-0,99%	-1,16%	-0,64%	0,31%	0,95%	0,59%
Bank Zachodni WBK S.A.	0,37%	0,16%	0,14%	1,01%	1,34%	n/a
Nordea AB	-0,07%	-0,12%	-0,02%	0,18%	0,52%	0,28%
Avg. peer	0,14%	-0,09%	0,00%	0,66%	1,28%	0,85%

Source: Annual Reports 2005-2010 & Bloomberg

Appendix 13: Capital Adequacy at Nordea Poland[149]

Capital Requirements	2009		2010 *	
	Capital requirement	RWA	Capital requirement	RWA
Credit risk	1.114.969	13.937.116	1.424.761	17.809.513
Settlement risk	-	-	-	-
Market risk	-	-	-	-
Operational risk (BIA)	52.481		62.977	-
Total	1.167.450	13.937.116	1.487.738	17.809.513

Exposure classes	Average risk weight	RWA	Capital requirement
Governments and central banks	0,01	30.335	2.427
Local authorities	0,02	17.578	1.406
Banks	0,24	278.155	22.252
Enterprises	0,74	5.185.973	414.878
Retail	0,64	756.702	60.536
Real estate	0,74	7.270.186	581.615
Overdue loans	1,28	84.875	6.790
Other	1,00	313.312	25.065
Total		13.937.116	1.114.969

Risk weight	Capital Requirement
0%	-
20%	12.212
35%	6.431
50%	11.026
75%	545.165
100%	535.506
150%	4.628
Total	1.114.969

Capital base	2009	2010 *
Own funds:		
Basic funds	739.454	
Capital/reserve funds	319.909	
-Deductions	- 44.740	
Total own funds	1.014.623	-
Additional own funds		
Complementary funds	157	
Supplementary funds	406.617	
Short-term capital	3.462	
Total additional own funds	410.236	-
Total capital base	1.424.859	2.017.745

Sources for all 4 tables: Nordea Poland Annual Report 2010 and Capital Adequacy & Risk Management Report

[149] The exposure classes and the risk weights are figures from 2009 since the 2010 figures are not yet available.

Appendix 14: Total Capital Ratio

TCR (in %)	2005	2006	2007	2008	2009	2010
Nordea Poland	11,89	9,64	11,63	8,63	9,76	10,85
PKO Bank Polski S.A.	13,90	11,80	12,02	11,29	14,66	n/a
Bank Pekao S.A.	19,50	16,50	12,12	12,20	16,20	n/a
BRE Bank S.A.	11,10	10,39	10,16	10,04	11,50	15,90
ING Bank Śląski S.A.	18,60	15,74	13,12	10,39	12,01	13,15
Bank Zachodni WBK S.A.	16,05	13,79	13,27	10,74	12,97	n/a
Nordea AB	9,20	9,80	9,10	9,50	11,90	11,50
Avg. peer	15,83	13,64	12,14	10,93	13,47	14,53

Source: Annual Reports 2005-2010

Appendix 15: Budgeting/Forecasting

Appendix: 15.1 Summery of Total Operating Income

	Explicit Forecast	Simplified Forecast								
Operating income	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Net interest income	614.331	828.105	1.105.585	1.418.112	1.547.495	1.689.239	1.844.548	2.014.748	2.201.293	2.405.782
% changes y/y	33%	35%	34%	28%	9%	9%	9%	9%	9%	9%
Net fee and commission income	118.316	147.895	170.079	187.087	205.795	226.375	249.012	273.913	301.305	331.435
% changes y/y	30%	25%	15%	10%	10%	10%	10%	10%	10%	10%
Net gain/losses on items at fair value	241.950	278.243	306.067	321.370	337.439	354.311	372.026	390.627	410.159	430.667
% changes y/y	20%	15%	10%	5%	5%	5%	5%	5%	5%	5%
Other operating income	35.872	37.666	39.549	41.527	43.603	45.783	48.072	50.476	53.000	55.650
% changes y/y	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Total operating income	1.010.468	1.291.908	1.621.280	1.968.095	2.134.332	2.315.707	2.513.659	2.729.765	2.965.756	3.223.534

Source: Own estimation

Appendix 15.2: Estimated Growth in Nordea Poland's Credit Portfolio

	Explicit Forecast			Simplified Forecast						
Total Loans (In PLN Thousand)	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Overdraft facilities	3.570.991	4.106.640	4.722.636	4.958.768	5.206.706	5.467.041	5.740.393	6.027.413	6.328.784	6.645.223
% change y/y	20%	15%	15%	5%	5%	5%	5%	5%	5%	5%
Operating loans	5.389.741	6.467.690	7.437.843	8.181.627	8.999.790	9.899.769	10.889.746	11.978.720	13.176.592	14.494.252
% change y/y	25%	20%	15%	10%	10%	10%	10%	10%	10%	10%
Investment loans	2.390.566	2.510.094	2.635.599	2.714.667	2.796.107	2.879.990	2.966.390	3.055.382	3.147.043	3.241.454
% change y/y	8%	5%	5%	3%	3%	3%	3%	3%	3%	3%
Guarantees	2.361.918	2.834.301	3.259.446	3.520.202	3.801.818	4.105.963	4.434.441	4.789.196	5.172.331	5.586.118
% change y/y	25%	20%	15%	8%	8%	8%	8%	8%	8%	8%
Mortgage loans	19.475.494	26.291.917	31.550.300	34.705.330	38.175.863	41.993.449	46.192.794	50.812.074	55.893.281	61.482.609
% change y/y	40%	35%	20%	10%	10%	10%	10%	10%	10%	10%
Other	3.368.706	4.042.447	4.648.814	5.113.696	5.625.065	6.187.572	6.806.329	7.486.962	8.235.658	9.059.224
% change y/y	20%	20%	15%	10%	10%	10%	10%	10%	10%	10%
Total Loans	36.557.416	46.253.088	54.254.638	59.194.289	64.605.349	70.533.785	77.030.093	84.149.746	91.953.690	100.508.880
% change y/y	30%	27%	17%	9%	9%	9%	9%	9%	9%	9%
Avg. earnings assets	32.333.189	41.405.252	50.253.863	56.724.464	61.899.819	67.569.567	73.781.939	80.589.920	88.051.718	96.231.285

Source: Own estimation

Appendix 15.3: Summery of Total Operating Expense

	Explicit Forecast	Simplified Forecast								
Operating expenses	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
General administrative expenses:										
- Staff costs	- 226.297	- 271.557	- 312.290	- 343.519	- 377.871	- 415.658	- 457.224	- 502.946	- 553.241	- 608.565
% changes y/y	20%	20%	15%	10%	10%	10%	10%	10%	10%	10%
- Other expenses	- 257.509	- 321.887	- 386.264	- 424.890	- 467.379	- 514.117	- 565.529	- 622.082	- 684.290	- 752.719
% changes y/y	20%	25%	20%	10%	10%	10%	10%	10%	10%	10%
Depreciation, amortisation and impairment charges of tangible and intangible assets	- 39.899	- 41.894	- 43.989	- 46.188	- 48.497	- 50.922	- 53.468	- 56.142	- 58.949	- 61.896
% changes y/y	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Total operating expenses	- 523.705	- 635.337	- 742.543	- 814.597	- 893.748	- 980.698	- 1.076.221	- 1.181.170	- 1.296.480	- 1.423.180

Source: Own estimation

Appendix 15.4: Summery of Total Capital Requirement

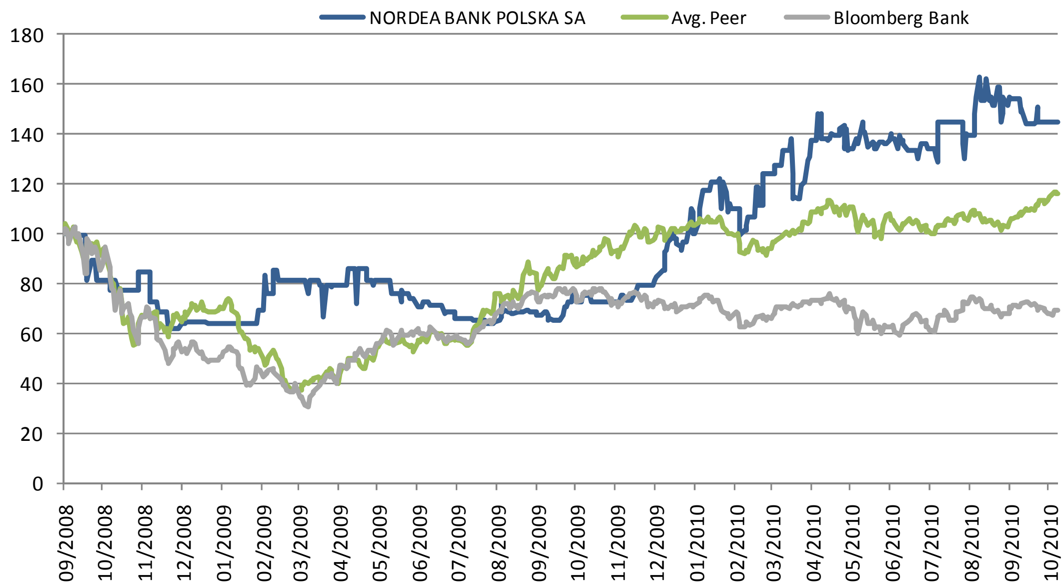
Total Capital Requirement	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Total Capital (CR)	0,08	0,08	0,08	0,08	0,08	0,08	0,08	0,08	0,08	0,08
Conservation buffer	-	-	-	-	-	0,00625	0,0125	0,01875	0,025	0,025
TCR	0,08	0,08	0,0800	0,0800	0,0800	0,08625	0,0925	0,0988	0,1050	0,1050
Total loan portfolio	36.557.416	46.253.088	54.254.638	59.194.289	64.605.349	70.533.785	77.030.093	84.149.746	91.953.690	100.508.880
Average risk weight	0,63	0,63	0,63	0,60	0,60	0,60	0,60	0,60	0,60	0,60
RWA (credit risk)	23.031.172	29.139.446	34.180.422	35.516.574	38.763.209	42.320.271	46.218.056	50.489.848	55.172.214	60.305.328
CR (credit risk)	1.842.494	2.331.156	2.734.434	2.841.326	3.101.057	3.650.123	4.275.170	4.985.872	5.793.082	6.332.059
Other CR	75.573	90.687	108.825	130.590	156.707	188.049	225.659	270.790	324.949	389.938
TCR	**1.918.066**	**2.421.843**	**2.843.258**	**2.971.915**	**3.257.764**	**3.838.172**	**4.500.829**	**5.256.663**	**6.118.031**	**6.721.998**
Change in TCR	430.328	503.776	421.416	128.657	285.849	580.408	662.657	755.834	861.368	603.967

Source: Own estimation

Appendix 16: The Current Share of Nordea Poland

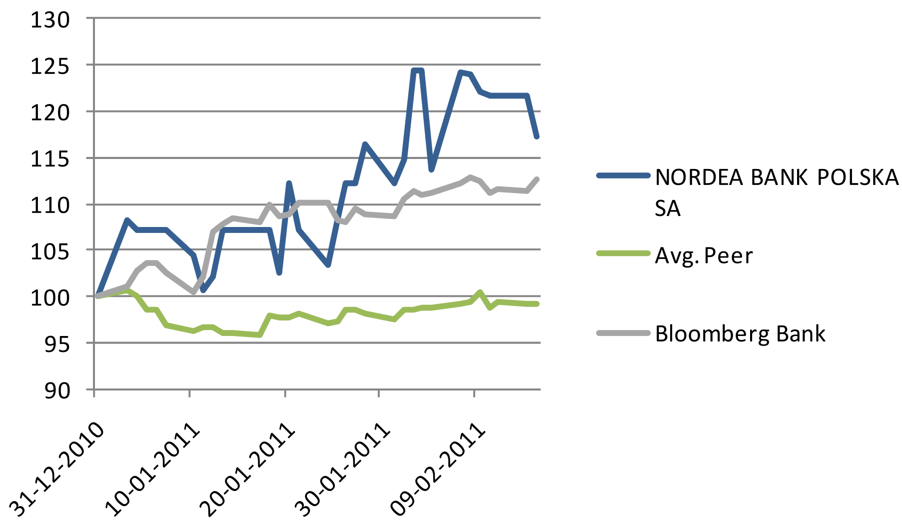
Nordea Poland's share was traded for the first time in 2001 after completing the merger with Bank Komunalny S.A. It trades under the symbol NDA.PW and is registered on the Warsaw stock exchange. The share is only traded in very limited volumes due to the fact that Nordea AB is the majority holder of the shares. This makes the price of the share reasonably more unstable since the bid/ask spreads can vary a lot.

When looking at the share price of Nordea Poland (the share prices in the figure have been indexed with a price of 100 starting at 01/09-2008) and how it has developed over time there are some interesting points to note.



First of all, when comparing Nordea Poland's share price with the share price development of the average peer group it becomes clear that the price of Nordea Poland since the end of 2009 has performed relatively better than the average peer group. This can be connected to the fact that Nordea Poland has shown signs of immense growth from this period and onwards. Furthermore, Nordea Poland's shares did not hit bottom during March 2009 as many other banking shares did and this is a sign of the share being relatively strong. Interesting is the fact that the share price did not react to the share capital increase the bank carried out during 2010. The share capital increase was registered on the 30th of July 2010 and during this period the share traded around a level of PLN 40.

When comparing the Nordea Poland's share to an average share price of European Banks (generic index covering the 500 largest banks in Europe) it becomes obvious that Nordea Poland's share has been one of the better banking shares in Europe. One could relate this to the fact that shares to a high degree are traded on expectation showing that investors believe Nordea Poland will be performing quite well going forward. This tendency is seen for the share price of the average peer group as well and could be related to the fact that investors believe the polish banking sector will be performing quite strong going forward.



Source: Bloomberg

Lastly, an interesting issue to note is that Nordea Poland has been performing especially well in the current year. Disregarding the fact that the share only is traded in limited volumes it seems the share has been performing exceptionally well in the last 1,5 moths. During the period where its peer group has been trading rather -3% Nordea Poland's share has risen with 15%.