mBank Dom Maklerski

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Wednesday, December 07, 2016 | periodic report

Monthly Report: December 2016

Equity Market, Macroeconomics

Equity Market

Markets are ignoring major issues as they focus all attention on the expected acceleration in the US and the Euro Area, and, for all we know, this "blindness" can last days or weeks. After the Italians rejected reforms, the ECB has to come to the rescue. Investor sentiment indicators show the market to be overheated at the moment.

Sector Outlook

Financial Sector

Banks are facing increasing pressure to voluntarily enable their FX mortgage customers to change loans into zlotys. This, combined with the ongoing work on FX spread refund legislation, and the upcoming announcement of size of the 2017 deposit guarantee contributions, is bound to keep sentiment toward the bank sector subdued throughout December. Outside of Poland, we see would take advantage of the recent price declines on European bank stocks like Erste and Komercni Banka to increase positions.

Gas & Oil

The November 2016 OPEC deal marks a turning point for the oil market, which is likely to move into a deficit as soon as in 2017. The changing market landscape is going to drive shifts in portfolio weightings away from refiners and petrochemical producers who, to date, have benefitted from cheap crude, in favor of upstream companies. Within our coverage universe, we see PGNiG as a top pick while our outlook on PKN Orlen remains bearish.

Power Utilities

European utilities have been trading lower in the past month as rising prices of coal and falling prices of emission credits drag. The uptrend in commodity prices, specifically crude oil and natural gas, is, however, working to the advantage of vertically-integrated generators like the Czech CEZ, for which we have a bullish outlook. Our top picks among Polish utilities, even with recommendations downgraded from buy to accumulate after recent upward shifts in share prices, are Energa and Tauron.

Telecoms, Media, IT

We maintain a positive view on Comarch, Ailleron, Atende, and Asseco Business Solutions, all plays on steady growth, healthy balance sheets, marketable IT solutions, and increasing exports. In media, we see upside potential in Agora, currently in the midst of restructuring its press business, and we like Wirtualna Polska, offering a unique business model, growth through online advertising and e-commerce, and dividend potential.

Manufacturers

65% of the companies tracked by us posted year-over-year earnings growth in Q3 2016, a stable ratio compared to the two previous quarters. At the same time, only 41% of these companies delivered positive surprises in the period – the lowest percentage since Q3 2015. For December, we see the most upside potential in Ergis, Feerum, Grajewo, Kernel, and Uniwheels, and we predict underperformance by Alumetal and Kruszwica.

Construction

Amid persistently unfavorable construction fundamentals, we would look for investment opportunities among the bigger general contractors like Budimex, Trakcja, Unibep, and Elektrobudowa, all of which confirmed their leading positions in their respective sectors with strong third-quarter results.

Real-Estate Developers

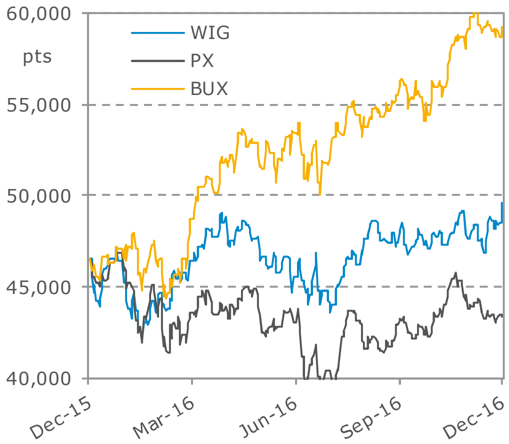
The residential sector is characterized by a stable supply accompanied by rising sales prices (+4.2% y/y in October). Within residential, we are overweight LC Corp, Atal, Lokum, Robyg, Dom Development, and Vantage. Commercial developers offer less upside, but they are far from overpriced.

Retail

CCC and LPP enjoyed strong sales in November, supported by favorable weather The restaurant operator AmRest delivered strong Q3 2016 results as it continues its expansion in the region. The supermarket operators Eurocash and Jeronimo Martins are poised for improvement as the inflation rate in Poland rises.

WIG 49,647
Average 2016E P/E 13.7
Average 2017E P/E 12.8
Avg. daily trading volume (3M) ..... PLN 798m

WIG vs. indices in the region



Rating changes

Company	Rating	Change
CEZ	Buy	▲
Energa	Accumulate	▼
Jeronimo Martins	Hold	▲
KGHM	Suspended	▶
PGNiG	Buy	▲
RBI	Hold	▼
Tauron	Accumulate	▼
Unibep	Buy	▲
Work Service	Suspended	▶

Research Department:

Michał Marczak
+48 22 438 24 01
michal.marczak@mbank.pl

Kamil Kliszcz
+48 22 438 24 02
kamil.kliszcz@mbank.pl

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl

Piotr Zybała
+48 22 438 24 04
piotr.zybala@mbank.pl

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

Paweł Szpigiel
+48 22 438 24 06
pawel.szpigiel@mbank.pl

Piotr Bogusz
+48 22 438 24 08
piotr.bogusz@mbank.pl

Equity Market

The US presidential election and the Italian constitutional referendum have shown a tendency in financial markets to respond to what they previously considered a risk with a rally, if only a short-lived one. When it comes Donald Trump as the next US president, investors seem to have bought into his economic vision in the hopes that his administration will not let him act on the more controversial ideas. As for Italy, the rejection of constitutional reforms will probably factor into the ECB's expected decision to extend QE this coming Thursday. Otherwise, financial markets seem to be ignoring the long list of issues that have emerged over the last few weeks. An interest rate hike in the US in December is now a near-certainty given the latest economic data, but this is already long priced-in. Sentiment gauges indicate that the market has become temporarily overheated, but history shows that trends are determined by money flows rather than indicators or valuations, and right now we are seeing a potential for a huge influx of capital driven by asset shifts from debt to equity.

While most major world economies, including the Euro Zone, register an acceleration, Poland is experiencing a contraction despite growing jobs and a welfare-driven boost to household income. The slowdown is reflected in decelerating industrial production, slower-than-expected growth in retail sales, and, most importantly, a continuing slump in public investment. If political risks are that persistent, why, then, has the WIG 20 index gone into a rally this December? The main reason was the inflow of capital into global ETFs which randomly buy up stocks without giving them much consideration. In addition, Standard & Poor's has just raised its outlook for Poland's BBB+ rating, which, to the surprise of many, it had not downgraded even after the recent reduction in the retirement age, from negative to stable, operating on the assumption of 3% GDP growth in 2017 compared to mBank's best-case forecast of 2.5% growth. As a result, foreign investors started to close short positions in Polish equities, especially bank stocks. Looking at the increasingly upbeat economic indicators in Europe, especially Germany, there is hope that the deceleration in Poland can be blamed on a slower-than-thought rise in consumption, and that public infrastructure spending will finally be revived by spring 2017.

Welcome President Trump,...

Against polls and most expectations, US voters picked Donald Trump to be their next President, and gave the Republican Party control of the Congress. Like it did after the Brexit vote, the market quickly flipped from a disaster mode to a buying frenzy after the announcement of the election results as Mr. Trump's "toned-down" first post-election speech was all it took to make believers out of investors and analysts. As much as they demonized Mr. Trump before the election, today the markets are as quick to price higher economic growth prospects for the US, seemingly forgetting (or, rather, dismissing as unrealistic) all of Mr. Trump's controversial campaign promises. Meanwhile, these promises are actually what won him votes, which means he will have to keep at least some of them to satisfy the electorate. For example, a US president can give an executive order for the US to withdraw from such international trade arrangements as the Trans-Pacific Partnership, the Trans-Atlantic Trade and Investment Partnership, and NAFTA. Aside from a few reasonable and easy-to-implement ideas (less regulation, less tax, energy self-sufficiency), Mr. Trump's economic platform is full of contradictions, and his ideas are bound to be watered down once they come up against the reality of US politics and economics.

One the effects of the US election was an increase in inflation expectations, leading to a sharp upturn in bond yields. A sell-off of Treasuries is driving an influx of capital into equities. In Europe, where the debt crisis is still evident, yields are kept low by the ECB (the yields on 10Y Italian, French, and Spanish bonds are lower than 10YUSA), which in January 2017 at the latest is expected to extend QE by six months at the stable level of EUR 80bn a month, or keep it going longer with reduced monthly asset purchases. The problem is that at EUR 80bn a month, next year the ECB will reach its debt holding limits per country (at 33% for Germany and Italy). This means that, before ideas can emerge on how to prevent the break-up of the European Monetary Union, at some point, we may start to see mounting uncertainty as to the future of the Euro Area.

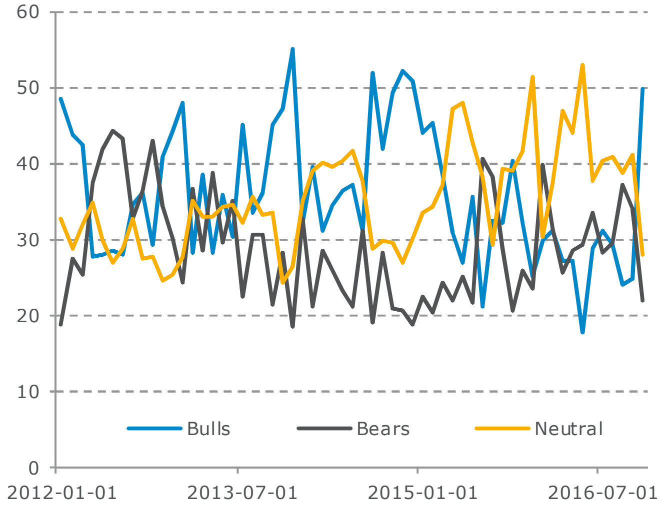
... Addio Prime Minister Renzi

Another side-effect Mr. Trump's win is that it has given a boost to populist movements in Europe which, next year, faces a spate of elections (including general elections in the Netherlands in March, in France in June, and in Germany in August-October, the April presidential election in France, and the Catalonia independence referendum in September). To boot, there are the upcoming Brexit negotiations. In Italy, the referendum defeat and resignation of PM Matteo Renzi threatens to spur a banking crisis, and this prospect can be taken as an opportunity by the market to speculate that the ECB has no choice but to extend QE. Today traders are betting on Italy forming a technocratic government that will provide help to ailing banks if necessary, and they assume that the populist Five Star Movement will not manage to rally enough votes to take power in the 2018 election. The political situation in Italy, and the outcomes of the upcoming elections in France and Germany, will be shaped largely by economic developments, with any slowdown boosting the chances of populists. At the moment, however, the European economy seems to be regaining momentum, and member states, being aware of the shifting public mindset, may be more inclined to initiate fiscal stimuli to support local growth.

Bulls versus Bears

According to the latest AAII Surveys, optimism among US individual investors has reached its highest level since the end of 2014, driven largely by high inflows into ETFs. According to the latest poll, the percentage of bulls at the end of November was 49.9% to 22.1% bears, with neutrals, of which there were a whopping 53% in a mid-year survey, shifting their money into more risky assets. The distance of the current bullish sentiment away from the averages indicates that the market is overheated right now.

AAII Sentiment Survey



Source: Bloomberg, Dom Maklerski mBanku

Jury Still Out On The Fate Of Polish Pension Funds

The market rebounded in July after the announcement of Polish pension reforms which made clear that the government would not be taking over all of the assets managed by privately-owned pension funds. According to media reports on the recent review of the pension system by the Ministry for Social Policy, the findings of which have not been made public, the government intends to keep to its original plan to leave 75% of the pension fund assets under their management. This would reduce the growing fears about the state pocketing all of the assets in the face of slowing economic growth. Moreover, despite the weaker momentum, the government has been generating higher revenues this year than last thanks to improved VAT recovery, higher dividends from the central bank, and a PLN 9bn one-time payment for LTE frequencies sold to telecoms. Looking at the increasingly upbeat economic indicators in Europe, especially Germany, there is hope that the deceleration in Poland can be blamed on a slower-than-thought rise in consumption, and that public infrastructure spending will finally be revived by spring 2017. This is tentatively backed by November's PMI gain from 50.2 to 51.9, led by rises in the Manufacturing index (up from 50.5 to 52.9) and the employment index (up from 51.5 to 53.9), though for a more conclusive take we need to see improving data for a few more months. At the moment, the consensus is for a continued deceleration through the first quarter of 2017, with a rebound coming in the second quarter. it is worth noting the increasing cost pressures faces by Polish businesses, caused by a weak zloty and rising commodity prices, pointed out by mBank economists.

Michał Marczak
tel. +48 22 438 24 01
michal.marczak@mbank.pl

Sector Outlook for December

Financial Sector

- Sentiment for the Polish bank sector will remain dampened in December by the intensified pressure coming from the government and financial regulators to compel banks to voluntarily convert CHF loans into zlotys. The FX borrower relief legislation currently tabled before the Polish Parliament, if passed, could cost the bank sector between PLN 9bn and PLN 70bn according to various estimates.
- The performance of PEO and PZU in December will be determined by the terms on which the latter will agree to buy UniCredit's 33% stake in the former. For PZU, the acquisition is a smart move and a good use of surplus capital, but for Pekao the partial divestment may give rise to uncertainty about future dividends, and selling pressure from UCI's remaining 7% stake.
- Key ratings: Erste Bank (buy), Komercni Banka (accumulate), PZU (buy)

Gas & Oil

- The agreement by OPEC members to reduce production to 32.5 million barrels per day as of January 2017, with Russia contributing its own cut of 0.3mmbbl, was welcomed by the market. If all the stakeholders follow through on their commitments, the global oil market will shift into a deficit as soon as in H1 2017, contrary to a pre-production-cut EIA prediction of an oil surplus of 0.8mmbbl per day in the first six months of next year.
- Refining margins, which have come under pressure in recent weeks, shrunk even lower, to less than $4 a barrel, after the OPEC meeting, and they are expected to tighten further looking at the record exports from China, coupled with a leveling-off in demand for gasoline in the US (with usage showing declines from the year-ago periods compared to rises at a rate of 3-4% seen in previous months). The outlook for the downstream sector is additionally clouded by a narrowing of the Urals/Brent spread as Iraq, Saudi Arabia, and Russia increase shipments of heavy crude oils.
- The OPEC deal also dealt another blow to the petrochemical industry, already beset with falling margins on olefins and polymers, led by increasing prices of naphtha and new capacity being launched in Egypt and Saudi Arabia. Next year, the global supply of polyolefins is set to be the biggest in years, fueled mainly by new steam crackers built in the US and China, and demand is not likely to catch up.
- Key ratings: PGNiG (buy), PKN Orlen (reduce)

Chemicals Producers

- Even though stock prices fell over the past month, the MSCI Europe Chemicals Index continues to trade at premiums to its three-year P/E and EV/EBITDA ratios.
- When it comes to the Q3 2016 earnings season, we witnessed worse-than-expected performance by Grupa Azoty and Synthos. Ciech as well, though its quarterly profits proved higher than anticipated, has seen its share price slide on a weak 2017 earnings outlook.
- Synthos is expected to enjoy positive market sentiment through to the end of 2016, owing to the rising prices of synthetic rubbers in rival China, coupled with the PLN 0.53 advance dividend payout coming in December, however our long-term view on the stock remains negative given the double-digit premiums at which it is valued relative to peers.
- Grupa Azoty shares are trading under pressure from an expected profit contraction and likely hikes in the costs of natural gas fuel.
- Key ratings: Synthos (sell)

Power Utilities

- European electricity prices have dropped below EUR 30/MWh due to a downward correction in year-ahead coal contracts and a slump in carbon allowances from just under EUR 6 o EUR 4 per ton on a lack of agreement on the EU Emissions Trading System reform. While the allowance market is due to stay down, the prices of coal are expected to recover soon, in line with the upward trend in oil and gas.
- In Poland, 1-year electricity contracts have not moved far beyond PLN 160/MWh in the past month despite speculation about an expected rebound in local coal prices. Spot coal prices at ARA ports are still nearly PLN 4/GJ higher than the prices in Poland, and with freight costs at PLN 3/GJ this leaves a window for arbitrage. The domestic lag is probably deliberate as the government continues to restructure state-run coal mines.
- Until recently, it seemed that the approval by the EU of the Polish capacity market proposal was a done deal, however in November the Commission announced a surprise proposal for an internal EU electricity market which provides for a reinforcement of cross-border trade and for emission restrictions on installations benefitting from capacity payments (a move which seems discriminatory against coal-fired power plants). The proposal is bound to spark long and heated debate within the EU, potentially leading to a delay in the implementation of the capacity payment mechanism in Poland, which would put into question the economic feasibility of the planned new power plant projects.
- Key ratings: CEZ (buy), Energa (accumulate), Tauron (accumulate)

Telecoms, Media, IT

- Poland's Digitization Minister Anna Streżyńska in a November interview dispelled the two main risks that had weighed on telecom stocks: (1) the rumored plans to impose a special tax on telecommunications operators, and (2) the speculation about another potentially capital-intensive frequency auction. According to Minister Streżyńska, there are plans to allocate 700 MHz frequencies, but not until 2022, unless telecoms express a desire to get them earlier.
- As P4, Orange Polska, and T-Mobile expand their LTE reach, Cyfrowy Polsat faces intensified competition in mobile broadband in regional and rural areas which could result in missed earnings forecasts in the coming years.
- The vision for the telecoms market outlined by the new Head of the Office for Electronic Communications Marcin Cichy includes the curbing off the downtrend in the retail telecommunications market which, according to him, is driven by low broadband penetration due to an insufficient and inefficient infrastructure, which he plans to address.
- Against this backdrop, our top telecoms pick for December is Orange Polska while our view on Cyfrowy Polsat remains bearish.
- In the media sector, our best bet at the moment is Agora, which has recently announced downsizing in its press segment in the face of falling revenues. The Company is also working on identifying other areas where cutbacks are possible. After reducing the payroll costs, Agora will be able to achieve positive EBITDA results in 2017-2019 while it transitions from print to digital.

- The Ministry for Digital Affairs last month stated that it wanted to address its IT needs by ordering services from a number of smaller local providers rather than awarding big contracts to a handful of the biggest companies. Moreover the Ministry intends to improve the process of allocating EU funding to ensure efficient and prudent expenditures. The shift in favor of smaller IT firms is bad news for the long-standing major government providers like Asseco Poland, Comarch, and Sygnity, though in the case of Comarch public orders account for less than 10% of total revenues.
- Our top IT picks for December are Atende, Comarch, and Asseco Business Solutions. We also maintain a positive view on Ailleron even though it share price has registered a considerable gain in the last few weeks.

Manufacturers

- Industrial stocks have been trading down in the past month on weak global manufacturing growth, with the MSCI Europe and World Industrials Indices currently valued at premiums to their 3-year P/E and EV/EBITDA ratios.
- 65% of the industrial companies tracked by us posted year -over-year earnings growth in Q3 2016, a stable ratio compared to the two previous quarters. At the same time, only 41% of these companies delivered positive surprises in the period - the lowest percentage since Q3 2015.
- The best Q3 2016 results were achieved by Ergis, Kernel, and Uniwheels, while Alumetal and Apator were the worst performers of the season.
- We maintain an overweight view on Elemental Holding (trading at 17-27% discounts to 2016-2017 peer P/E, and generating strong y/y earnings rebound this year without the help of acquisitions), Ergis (trading at 27-33% discounts to 2016 and 2017 peer multiples despite solid 2016 ytd earnings growth), Pfleiderer (trading at a 40% discount to 2016-2017E peer EV/EBITDA; Pfleiderer is expected to make an effort to reduce financing costs soon, and it is benefitting from an appreciating Russian ruble), Kernel (capitalizing on an ample sunflower seed supply after a bumper harvest, expected to boost crushing margins), Tarczyński (which is valued at 9-38% discounts to 2016-2017E peer P/E and EV/EBITDA ratios, and which is set for strong revenue growth going forward thanks to a long-term sausage supply contract with Poland's biggest supermarket chain), and Uniwheels (poised for sustained profit expansion in 2017 following the launch of a new production facility; Uniwheels offers one of the highest dividend yields in the auto parts sector).
- We remain underweight Alumetal (expected to report falling earnings in Q4'16 and Q1'17, and deliver flat-to-weaker profits in 2017), and Kruszwica (poised for a slow 2017 due to a persistent undersupply of rapeseed for crushing).
- Key ratings: Elemental (buy), Kernel (accumulate), Uniwheels (accumulate)

Construction

- Polish building activity registered continued contraction in October at an annual rate of 20%, and this, combined with the recovery observed in the prices of key commodities (oil, steel), indicates strong downward pressure on the profits of construction companies.
- November was a disappointing month for railway builders in terms of new government orders, which unexpectedly proved few and far between after rebounding in October. We are hoping to see a revival in public infrastructure spending in December.
- The Q3 2016 earnings season proved successful for sector leaders like Budimex, Trakcja, and Elektrobudowa, while smaller players like Elektrotim, Herkules, ZUE, and Torpol, posted negative surprises. The construction sector as a whole achieved 13% year-over-year growth in its aggregate EBITDA, however excluding Budimex the quarterly EBITDA shows a 20% drop.
- Amid challenging fundamentals, our top picks for December are builders with strong backlogs: Budimex, Trakcja, Unibep, Erbud, and Elektrobudowa.
- Key ratings: Elektrobudowa (buy), Unibep (buy), Budimex (accumulate), Erbud (buy).

Real-Estate Developers

- New home starts by Polish developers in the last twelve months amounted to a stable 85-90 thousand, while building permits declined slightly in September and October. With most residential developers reporting strong sales this year, the likelihood of a housing oversupply is nonexistent, and the strong prospects for housing are reflected in the 4.2% y/y October gain (the strongest in 31 months) in the ICT home price index.
- Most developers reported better-than-expected earnings for Q3 2016, with Atal, Robyg, LC Corp, and Echo leading the way.
- We are overweight residential developers (LC Corp, Atal, Lokum, Robyg, Dom, Vantage), and we maintain a neutral view on commercial developers (GTC, Echo, Capital Park).
- Key ratings: Robyg (buy), Dom Development (buy).

Retail

- The planned new retail sales tax is being investigated for a possible violation of the EU state aid rules, and it is on hold until the end of 2017. The latest proposal is to fix the tax at 1.2-1.5%.
- The other major risk faced by Polish retailers is the Sunday trading ban legislation submitted to the Parliament, which could enter into force in 2017.
- AmRest delivered strong results for Q3 2016, with the EBIT margin maintained at a stable level despite rising pay pressures and the low profits generated by the German business. Consistently with its business strategy, toward the end of November AmRest announced plans to buy 15 KFC locations in Germany.
- For Eurocash, Q3 2016 was a confirmation of issues at the cash&carry business and the Delikatesy Centrum supermarket chain. In November, the Company said there was hope it would be able to finalize two planned acquisitions by February 2017. Eurocash's outlook is supported by the rising inflation rate for food and beverages in Poland.
- At LPP, a slowdown in monthly sales in November was accompanied by an expansion in the monthly gross margin at the highest annual rate in two years. In the periods ahead, the sales revenue will be supported by the increasing sales generated by the Russian stores, reinforced by an appreciating ruble and positive base effects. Overall, LPP's 2016 autumn/winter fashion collections have been a success among shoppers. With all that being said, we have a hold rating for LPP after the 50% surge in the share price since the end of September.

Macroeconomics

Polish GDP growth in Q3

A second measurement confirmed that Polish GDP expanded at an annual rate of 2.5% in Q3 2016. Looking at the composition, the 500+ family benefits had less of an impact on consumption in the period than hoped (with consumption growth up from 3.1% at the beginning of the year to just 3.9% in Q3) even though they accounted for 40% of the increase in real disposable income. In addition, investment fell 7.7% y/y in Q3, a shift which is quite similar to the soft patch noted in 2012-2013, only much deeper. The GDP got a huge boost from inventories (+1.1ppt) and a relatively small setback from net exports (-0.3ppt) in Q3. The former implies that inventories have already adjusted to the production drop. The upcoming quarters should show more regular, procyclical changes in inventories. The latter category's behavior is a deviation from other measures of foreign trade (NBP and Eurostat data, industrial production) and could be revised in near future, producing a favorable comparable base for the second half of 2017. Moving on to future quarters, we see an acceleration in consumption in Q4 and a rebound in investment activity in 2017, even if tempered by weaker exports and negative contributions from net exports. At the same time, a revision of the 2015 data (with Q4 2015 GDP growth raised from 4.3% to 4.6%) has created a negative base for Q4 2016 GDP growth and public spending. Accordingly, we expect Polish GDP to decelerate to 1.7% in Q4. The slowdown in Polish economic growth is running much deeper than predicted by analysts. Even if the impending rebound in EU-funded investment proves enough to bring growth back over the 3% threshold in H2 2017, the global environment still poses a threat. A deflationary environment and weak growth in Europe could negatively affect Polish exports, while a possible escalation of the financing problems of EMs can hamper export diversification outside EU. Consequently, we do not think inflationary pressures are in the cards for Poland in the medium term, meaning interest rate hikes are definitely off the table for the foreseeable future. The disappointing Q3 growth is likely to dampen business sentiment and put an end to the overoptimistic comments by the Monetary Council about the state of the economy, eventually resulting in much more dovish statements. We are looking forward to a shift in the policy stance now that it is clear the investment in Poland has been half of what had been projected by the central bank.

Industrial production in October 2016

Poland's industrial production showed contraction at an annual rate of 1.3% in October after rising 3.2% in September, though adjusted for working-day effects the October output was up 1.3% y/y vs. 3.3% the month before. 20 out of 34 sectors, including energy and coke producers, experienced increased activity in October. Broadly speaking, the October manufacturing slowdown was driven by declining exports to Germany coupled with a continuing investment slump. The acceleration in consumption fueled by the 500+ family benefits is not as strong as anticipated, and what is more it is mostly driving imports rather than providing a stimulus for domestic production. Construction output was down 20.1% y/y in October, falling far short of market expectations which put the contraction at closer to 14–15%. The seasonally adjusted annual slowdown is 17%. October saw a slump in monthly activity for construction companies across the board, with the future outlook turning from bad to worse. as public infrastructure orders show no signs of a rebound.

Retail sales

Retail sales were 3.7% lower in October 2016 than in the same month in 2015,due to a 4% decrease in auto sales and a 9.7% drop in "other" sales, marking the second month straight of disappointing growth in two heavyweight sectors characterized by substantial volatility. With the market environment still very much conducive to growth, underpinned by high consumer confidence, increasing household income, and extensive welfare programs, we view the October slowdown as an outlier and we expect an above-trend rebound in November. With that said, the disappointing October retail sales data add to the overall economic weakness observed in the fourth quarter.

Inflation

The consumer price index registered a zero rate of inflation in November versus a 0.2% decrease in October, marking the end of 28-month deflation in Poland. On a month-on-month basis consumer prices rose by 0.1%. Details pending, we can guess that the November price gains may have been driven by food (0.4% m/m) while fuel prices stabilized. The other categories will have been stable relative to the previous months. According to our estimates, the core CPI declined by 0.1% y/y in November vs. -0.2% in October. Price pressures are still very fragile not only in Poland, but also in Europe, and the yearly price indices are showing upward movement thanks only to positive year-ago base effects in energy prices. In the months ahead, we expect to see a gradual acceleration in the inflation rate. which we think will reach 1.5% around April 2017. This (global) trend keeps in check the pricing of any rate cuts in Poland. Only in a few months we will see if, after running out of "base-effects" steam, the inflation rate will assume a steady upward pace, even if much slower than central bank target. The Monetary Council will keep rates unchanged during its December 7th meeting, however it is bound to change its rhetoric. The Council's original projections are very obviously looking divorced from reality at this point, and in Q4 we are in for a further slowdown. We believe the policymakers should at least acknowledge the possibility of rate cuts, especially given that the NBP's inflation projection indicates an inflation rate below target throughout the whole forecast window. Given Poland's financial balance structure, the Monetary Council does not have to react to a currency depreciation or a growth slowdown by rising interest rates (unlike e.g. Turkey). Thus, we consider the current levels at the short-end of the yield curve in Poland an aberration and not a well-founded bet on a macroeconomic scenario. Lower rates and a weaker currency can serve as mechanisms to balance the economy in a natural way.

Jobs

Private sector employment increased 3.1% y/y in October 2016, in line with consensus, confirming a continued steady upward job momentum. Compared to September the economy added just under 8,000 jobs last month, a modest result compared to the best Octobers in history. As we wait for the detailed jobs report, we can guess that, with the mitigation of the unusual gyrations in certain sectors seen in the preceding months, October job growth was led by longer and more stable trends in manufacturing (where hiring is on the rise) and mining (where there is downsizing). The labor market is not showing signs of tightening for now, which may have been postponed by the soft patch seen in the second half of 2016. The average salary increased 3.6% y/y in October, a slowdown from 3.9% in September, though adjusted for working-day effects the monthly momentum remained stable. Contrary to some leading survey-based indicators, we are not observing a material acceleration in salary growth in Poland. The likely reason is the huge influx of migrant labor from Ukraine (around 1.2 million now). Such a hypothesis would explain the flat prices of services and the lack of an obvious pay impact of the beneficiaries of the 500plus family benefits who decide to quit the workforce. Moreover according to official surveys the current job growth in Poland comes mainly from low-wage sectors.

mBank Department of Economic Analysis
(Ernest Pytlarczyk, Marcin Mazurek)
research@mBank.pl

Current Recommendations by Dom Maklerski mBanku

Company	Recommendation	Date issued	Price on report date	Target price	Current price	Upside / Downside	P/E 2016	P/E 2017	EV/EBITDA 2016	EV/EBITDA 2017
Banks										
ALIOR BANK	Buy	2016-05-24	55.40	75.93	45.29	+67.7%	13.7	128.7		
BZ WBK	Hold	2016-08-03	301.25	305.10	296.80	+2.8%	13.5	13.3		
GETIN NOBLE BANK	Buy	2016-02-02	1.38	2.89	1.17	+147.0%	29.8	16.3		
HANDLOWY	Hold	2016-10-05	78.08	75.32	71.20	+5.8%	15.0	15.5		
ING BSK	Sell	2016-10-05	146.90	119.38	156.00	-23.5%	21.3	19.4		
MILLENNIUM	Buy	2016-02-02	5.20	7.00	5.17	+35.4%	11.5	9.2		
PEKAO	Hold	2016-08-03	124.75	127.42	121.30	+5.0%	15.5	15.1		
PKO BP	Buy	2016-02-02	24.84	31.62	26.82	+17.9%	11.7	10.8		
KOMERCNI BANKA	Accumulate	2016-11-04	891.50	980.00 CZK	882.00	+11.1%	12.9	14.1		
ERSTE BANK	Buy	2016-02-02	26.17	32.34 EUR	26.61	+21.6%	9.9	8.9		
RBI	Hold	2016-12-06	17.14	17.14 EUR	17.14	+0.0%	18.6	6.2		
OTP BANK	Reduce	2016-10-05	7,498	6,487 HUF	8,011	-19.0%	12.3	10.0		
Insurance										
PZU	Buy	2016-02-02	32.33	42.44	29.82	+42.3%	11.0	9.1		
Financial services										
KRUK	Hold	2016-08-03	219.10	211.44	206.20	+2.5%	15.1	12.9		
PRIME CAR MANAGEMENT	Buy	2016-02-02	35.10	46.76	33.30	+40.4%	9.2	9.3		
SKARBIEC HOLDING	Buy	2016-02-02	27.00	42.20	31.89	+32.3%	8.4	7.3		
Fuels, chemicals										
CIECH	Hold	2016-11-16	60.85	61.60	55.98	+10.0%	6.0	10.7	5.0	6.5
GRUPA AZOTY	Hold	2016-08-30	64.79	65.50	60.00	+9.2%	11.7	14.9	5.9	6.9
LOTOS	Hold	2016-04-19	28.09	26.50	37.31	-29.0%	12.5	11.4	6.3	6.3
MOL	Hold	2016-04-19	16,420	16,593 HUF	18,600	-10.8%	16.7	11.9	5.1	4.4
PGNIG	Buy	2016-12-06	5.20	6.06	5.20	+16.5%	14.2	12.7	5.5	5.0
PKN ORLEN	Reduce	2016-04-19	71.18	59.00	80.40	-26.6%	9.1	10.5	5.6	6.2
POLWAX	Buy	2016-02-02	15.70	23.24	16.89	+37.6%	7.1	7.1	5.8	5.4
SYNTHOS	Sell	2016-11-04	4.57	3.39	4.50	-24.7%	19.7	15.8	11.5	10.0
Power Utilities										
CEZ	Buy	2016-12-06	407.00	496.80 CZK	407.00	+22.1%	11.6	13.7	6.2	6.5
ENEA	Hold	2016-10-04	8.45	8.81	9.60	-8.2%	5.4	6.2	4.4	4.5
ENERGA	Accumulate	2016-12-06	8.19	9.20	8.19	+12.3%	280.6	6.7	4.3	4.2
PGE	Hold	2016-10-04	10.18	10.63	9.22	+15.3%	9.7	7.6	3.8	4.5
TAURON	Accumulate	2016-12-06	2.66	3.03	2.66	+13.9%	8.7	4.7	4.2	4.5
Telecommunications										
NETIA	Accumulate	2016-06-08	5.05	5.30	4.52	+17.3%	-	-	4.3	4.9
ORANGE POLSKA	Buy	2016-11-16	5.23	7.00	5.25	+33.3%	101.5	151.7	4.4	4.5
Media										
AGORA	Buy	2016-10-05	10.65	12.60	11.00	+14.5%	-	-	6.9	6.6
CYFROWY POLSAT	Reduce	2016-09-13	24.25	21.80	24.30	-10.3%	17.1	14.9	7.5	7.3
WIRTUALNA POLSKA	Accumulate	2016-11-18	54.00	60.00	51.26	+17.1%	27.0	19.7	13.1	11.2
IT										
ASSECO POLAND	Hold	2016-09-26	57.25	60.60	52.74	+14.9%	14.0	12.9	6.8	6.5
CD PROJEKT	Sell	2016-08-03	34.00	26.50	53.68	-50.6%	45.4	70.6	33.4	52.9
COMARCH	Buy	2016-08-16	166.00	200.00	172.95	+15.6%	21.6	16.2	8.6	7.5
SYGNITY	Suspended	2013-02-05	16.80	-	5.46	-	-	-	-	-
Mining & Metals										
KGHM	Suspended	2016-12-06	91.84	-	91.84	-	-	-	-	-
LW BOGDANKA	Sell	2016-08-03	52.00	33.00	69.49	-52.5%	10.7	13.3	4.1	4.5
Manufacturers										
ELEMENTAL	Buy	2016-06-13	3.50	4.60	3.63	+26.7%	12.7	10.4	10.4	8.1
FAMUR	Suspended	2016-11-30	4.22	-	4.28	-	-	-	-	-
KERNEL	Accumulate	2016-11-15	57.70	64.60	65.80	-1.8%	5.6	5.0	4.4	3.8
KĘTY	Hold	2016-07-01	318.90	291.10	376.20	-22.6%	14.2	17.1	10.5	10.1
UNIWHEELS	Accumulate	2016-10-19	205.00	224.20	208.05	+7.8%	12.4	9.7	9.1	7.3
VISTAL	Hold	2016-11-25	9.90	9.90	8.60	+15.1%	9.7	9.6	9.7	9.4
Construction										
BUDIMEX	Accumulate	2016-10-05	207.00	225.60	203.85	+10.7%	16.2	14.2	6.9	6.4
ELEKTROBUDOWA	Buy	2015-12-03	141.00	166.50	94.00	+77.1%	8.1	7.9	4.5	4.1
ERBUD	Buy	2016-02-03	25.95	36.00	27.00	+33.3%	9.7	8.8	4.7	4.4
UNIBEP	Buy	2016-12-06	10.00	12.10	10.00	+21.0%	10.5	8.5	6.5	5.4
Property Developers										
CAPITAL PARK	Hold	2016-04-06	6.55	6.50	6.30	+3.2%	48.1	15.7	30.8	20.1
DOM DEVELOPMENT	Buy	2016-05-30	54.40	69.50	57.80	+20.2%	11.4	9.5	9.2	7.7
ECHO	Hold	2016-04-06	6.52	2.73	5.96	-54.2%	11.0	10.2	16.3	13.6
GTC	Hold	2016-10-05	8.25	8.20	8.17	+0.4%	10.8	4.8	13.5	7.4
ROBYG	Buy	2016-10-28	2.93	3.89	2.98	+30.5%	8.3	8.6	10.4	10.0
Retail										
AMREST	Reduce	2016-09-16	252.00	236.00	285.00	-17.2%	34.6	29.6	13.6	11.2
CCC	Hold	2016-08-03	184.00	181.00	195.95	-7.6%	28.4	20.9	18.9	14.4
EUROCASH	Accumulate	2016-11-04	37.40	42.70	37.00	+15.4%	20.2	17.4	10.6	9.0
JERONIMO MARTINS	Hold	2016-12-06	14.67	14.90 EUR	14.67	+1.6%	24.0	20.3	10.9	9.4
LPP	Hold	2016-11-04	5,615	5,500	5,949	-7.5%	42.0	22.1	19.9	12.6
Other										
WORK SERVICE	Suspended	2016-12-06	10.17	-	10.17	-	-	-	-	-

Ratings Issued in the Past Month

Company	Rating	Previous Rating	Target Price	Rating Day
Ciech	Hold	Hold	61.60	2016-11-16
Kernel	Accumulate	Hold	64.60	2016-11-15
Orange Polska	Buy	Buy	7.00	2016-11-16
Vistal Gdynia	Hold	Buy	9.90	2016-11-25
Wirtualna Polska	Accumulate	Accumulate	60.00	2016-11-18

Ratings Changed as of 6 December 2016

Company	Rating	Previous Rating	Target Price	Rating Day
CEZ	Buy	Accumulate	CZK 496.80	2016-12-06
Energa	Accumulate	Buy	9.20	2016-12-06
Jeronimo Martins	Hold	Reduce	EUR 14.90	2016-12-06
KGHM	Suspended	Reduce	-	2016-12-06
PGNiG	Buy	Accumulate	6.06	2016-12-06
RBI	Hold	Buy	EUR 17.14	2016-12-06
Tauron	Accumulate	Buy	3.03	2016-12-06
Unibep	Buy	Accumulate	12.10	2016-12-06
Work Service	Suspended	Accumulate	-	2016-12-06

Ratings Statistics

Rating	All		For Issuers Who are Clients of Dom Maklerski mBanku	
	Count	As pct. of total	Count	As pct. of total
Sell	4	7.0%	1	4.8%
Reduce	4	7.0%	1	4.8%
Hold	20	35.1%	6	28.6%
Accumulate	9	15.8%	4	19.0%
Buy	20	35.1%	9	42.9%

List of abbreviations and ratios contained in the report.
EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

Recommendations of Dom Maklerski mBanku :
A recommendation is valid for a period of 6-9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:
BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from –5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
Recommendations are updated at least once every nine months.

mBank S.A. with its registered office in Warsaw at Senatorska 18 renders brokerage services in the form of derived organisational unit – Brokerage Office which uses name Dom Maklerski mBanku.

The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which Dom Maklerski mBanku considers reliable, including information published by issuers, shares of which are subject to recommendations. However, Dom Maklerski mBanku, in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts.

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Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation.

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The present report was not transferred to the issuer prior to its publication.

The production of new recommendations was completed on December 6, 2016, 1:25 PM.
New recommendations were first disseminated on December 6, 2016, 1:25 PM.

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The present Monthly Report exclusively contains information previously published by Dom Maklerski mBanku and only comprises a comprehensive presentation of unaltered data. The information, including recommendations, contained in the Monthly Report has been published in separate reports, the publication dates of which are located on page 8 of the Monthly Report.

In connection with the above, Dom Maklerski mBanku does not consider the Monthly Report to be a recommendation as understood in the Order of the Council of Ministers, dated 19 October 2005, in regard to information comprising recommendations concerning financial instruments or their issuers.

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Strong and weak points of valuation methods used in recommendations:
DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.
Comparative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.
Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.
Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.
NAV - valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

Recent ratings for companies re-rated as of the date of this Monthly Report:

CEZ

Rating	Buy	Accumulate	Accumulate	Buy	Buy
Rating date	2016-12-06	2016-10-04	2016-08-03	2016-02-02	2015-12-14
Price on rating day	CZK 407.00	CZK 436.00	PLN 73.03	PLN 65.00	PLN 69.00
WIG on rating day	49,647.48	47,399.32	47,031.70	44,294.89	44,220.32

ENERGA

Rating	Accumulate	Buy	Suspended	Buy	Accumulate
Rating date	2016-12-06	2016-10-04	2016-03-16	2016-03-04	2016-02-02
Price on rating day	8.19	7.40	13.30	13.11	13.48
WIG on rating day	49,647.48	47,399.32	47,114.63	46,448.27	44,294.89

JERONIMO MARTINS

Rating	Hold	Reduce	Hold	Buy
Rating date	2016-12-06	2016-10-05	2016-04-18	2016-02-02
Price on rating day	EUR 14.67	EUR 16.01	EUR 14.76	EUR 13.08
WIG on rating day	49,647.48	47,900.66	48,095.43	44,294.89

KGHM

Rating	Suspended	Reduce	Hold	Under Review
Rating date	2016-12-06	2016-08-03	2016-02-02	2015-12-03
Price on rating day	91.84	78.20	56.26	68.15
WIG on rating day	49,647.48	47,031.70	44,294.89	47,002.61

PGNIG

Rating	Buy	Accumulate	Accumulate	Buy	Accumulate	Hold	Hold
Rating date	2016-12-06	2016-07-27	2016-06-02	2016-05-06	2016-04-19	2016-02-02	2015-12-03
Price on rating day	5.20	5.50	5.13	4.92	5.10	5.04	5.24
WIG on rating day	49,647.48	46,905.60	44,700.67	46,430.16	48,195.06	44,294.89	47,002.61

RBI

Rating	Hold	Buy
Rating date	2016-12-06	2016-02-02
Price on rating day	EUR 17.14	EUR 11.32
WIG on rating day	49,647.48	44,294.89

TAURON

Rating	Accumulate	Buy	Buy	Buy
Rating date	2016-12-06	2016-10-04	2016-02-02	2015-12-14
Price on rating day	2.66	2.55	2.71	2.63
WIG on rating day	49,647.48	47,399.32	44,294.89	44,220.32

UNIBEP

Rating	Buy	Accumulate	Hold	Buy	kupuj
Rating date	2016-12-06	2016-11-04	2016-09-06	2016-02-03	2016-02-02
Price on rating day	10.00	10.85	11.79	9.89	9,89
WIG on rating day	49,647.48	47,899.61	47,980.57	43,563.88	44 294,89

WORK SERVICE

Rating	Suspended	Accumulate
Rating date	2016-12-06	2016-02-02
Price on rating day	10.17	11.96
WIG on rating day	49,647.48	44,294.89

Dom Maklerski mBanku
Senatorska 18
00-082 Warszawa
http://www.mbank.pl/

Research Department

Kamil Kliszcz
director
tel. +48 22 438 24 02
kamil.kliszcz@mbank.pl
energy, chemicals, power generation

Michał Marczak
tel. +48 22 438 24 01
michal.marczak@mbank.pl
strategy, resources, metals

Michał Konarski
tel. +48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Jakub Szkopek
tel. +48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals

Paweł Szpigiel
tel. +48 22 438 24 06
pawel.szpigiel@mbank.pl
media, IT, telco

Piotr Zybała
tel. +48 22 438 24 04
piotr.zybala@mbank.pl
construction, real-estate development

Piotr Bogusz
tel. +48 22 438 24 08
piotr.bogusz@mbank.pl
retail

Sales and Trading

Traders

Piotr Gawron
director
tel. +48 22 697 48 95
piotr.gawron@mbank.pl

Krzysztof Bodek
tel. +48 22 697 48 89
krzysztof.bodek@mbank.pl

Mateusz Choromański, CFA
tel. +48 22 697 47 44
mateusz.choromanski@mbank.pl

Tomasz Jakubiec
tel. +48 22 697 47 31
tomasz.jakubiec@mbank.pl

Anna Łagowska
tel. +48 22 697 48 25
anna.lagowska@mbank.pl

Adam Prokop
tel. +48 22 697 47 90
adam.prokop@mbank.pl

Szymon Kubka, CFA, PRM
tel. +48 22 697 48 16
szymon.kubka@mbank.pl

Jędrzej Łukomski
tel. +48 22 697 49 85
jedrzej.lukomski@mbank.pl

Tomasz Galanciak
tel. +48 22 697 49 68
tomasz.galanciak@mbank.pl

Wojciech Wysocki
tel. +48 22 697 48 46
wojciech.wysocki@mbank.pl

Sales, Foreign Markets

Marzena Łempicka-Wilim
deputy director
tel. +48 22 697 48 82
marzena.lempicka@mbank.pl

Mariusz Adamski
tel. +48 22 697 48 47
mariusz.adamski@mbank.pl

Private Broker

Kamil Szymański
director, active sales
tel. +48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak
deputy director, active sales
tel. +48 22 697 48 70
jaroslaw.banasiak@mbank.pl