ProCredit Holding

Q121 results

On track to scale the business further

Banks

ProCredit Holding (PCB) improved its profitability in Q121 with an annualised return on equity (ROE) of 7.9% versus 7.0% in Q120, as the impact of central bank rate cuts across the region was offset by growth in customer loans, limited loss allowances and good operating costs control. As macro conditions normalise further and PCB continues to grow its business in the coming years, we expect the company to realise its scaling potential and gradually reach its mid-term ROE target of 10% (which we expect in FY23e).

Year end	Net interest income (€m)	EPS (€)	DPS (€)	P/BV (x)	P/E (x)	ROE (%)	Yield (%)
12/19	194.5	0.89	0.00	0.7	9.8	6.9	N/A
12/20	201.6	0.70	0.53	0.7	12.4	5.3	6.1
12/21e	208.4	0.92	0.31	0.6	9.5	6.8	3.6
12/22e	230.1	1.30	0.43	0.6	6.7	9.1	4.9

Note: ProCredit, Edison Investment Research. Note: *From total operations.

Lower loss allowances and operating costs in Q121

PCB managed to expand its gross loan book by 3.0% in Q121, with all of its regional banks (except for the minor operations in Germany) growing at 2% or more. Moreover, its deposit base rose by 2.5% q-o-q, due mainly to private individual clients. Still, net interest income declined by 3.2% y-o-y to €49.3m and the net interest margin (NIM) narrowed to 2.7% (versus 3.1% in Q120) primarily due to central bank rate cuts. Furthermore, PCB recognised an earnings-neutral accounting effect (discussed below), which led to a €1.3m reallocation from net interest income to loss allowances (with an annualised cost of risk of 27bp in Q121 versus 57bp in Q120). Finally, PCB realised cost savings related to COVID-19 (eg in travel expenses) but also business optimisation/restructuring (in particular in Romania), which led to a c 2.5% y-o-y decline in operating expenses to €40.7m in Q121 and in turn a robust 13.8% y-o-y increase in net income to €15.6m.

Management guidance reiterated

Following a solid set of Q121 figures, management reiterated its FY21 guidance, implying an ROE of 6.0–7.5% (versus our forecast of 6.8%), an elevated cost of risk but below FY20 (we assume 41bp), a cost income ratio (CIR) of 65–68% (we forecast 66.5%) and a CET1 ratio of 13% (versus 13.3% in FY20 and in line with our forecast). We have made only minor (c 3%) positive changes to our net income forecasts, primarily due to lower operating expenses assumptions. PCB's mid-term targets (discussed in our previous note) also remained unchanged.

Valuation: Shares still trade below our fair value

We continue to value PCB's shares using a P/BV-ROE approach. Our fair P/BV multiple of 0.90x used in the valuation is the average of a multiple derived from a capital asset pricing model of 1.05x and a ratio implied by a regression line based on FY20 figures for peers and PCB of 0.75x. We arrive at a fair value of €11.20 per share (last updated 4 May 2021), which at present implies c 28% upside potential.

20 May 2021

Price	**€8.7**
Market cap	**€512m**
Total assets (€bn) at end March 2021	7.5
Shares in issue	58.9m
Free float	35.7%
Code	PCZ
Primary exchange	Frankfurt Prime Standard
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(4.6)	4.2	76.8
Rel (local)	(3.0)	3.5	29.6
52-week high/low	€9.24	€4.78	

Business description

ProCredit is a German-based group operating regional banks across Southeastern and Eastern Europe, as well as in Ecuador. The banks focus on SMEs and private middle-income and high earners. At end-March 2021, the group's total assets stood at €7.5bn.

Next events

AGM	27 May 2021
Q221 results	12 August 2021

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Q121 results: Annualised ROE improving to 7.9%

Below we present a summary of PCB's Q121 results compared to Q120. Net profit in Q121 was €15.6m (up 13.8% y-o-y), implying an annualised ROE of 7.9% versus 7.0% in Q120. Following a solid set of Q121 figures, management confirmed its FY21 guidance of loan portfolio growth of c 10% (in line with its mid-term target) and an ROE between 6.0% and 7.5%, assuming a still elevated cost of risk, though below the FY20 level. PCB still targets a CIR of 65–68% and expects a CET1 ratio of 13% (versus 13.3% in FY20).

Exhibit 1: ProCredit Holding's Q121 results highlights

€m, unless otherwise stated	Q121	Q120	y-o-y % change
Net interest income	49.3	50.9	-3.2%
NIM (annualised)	2.7%	3.1%	-36 bp
Expenses for loss allowances	3.6	6.9	-47.3%
Cost of risk (annualised, bp)	27	57	-30 bp
Net fee and commission income	12.0	12.0	-0.1%
Pre-tax profit	18.5	16.0	15.4%
Net income	15.6	13.7	13.8%
CIR	64.8%	64.6%	22 bp
CET-1 ratio	13.2%	14.0%	-0.8 pp
Gross loan portfolio growth (q-o-q)	3.0%	0.9%	2.1 pp
Customer deposits growth (q-o-q)	2.5%	-1.7%	4.2 pp

Source: Company accounts

Gross loan book up c 3% during the quarter, deposits up 2.5%

Despite Q1 being a relatively quiet season normally, PCB was able to grow its customer loan book by a solid 3% (or €158m) versus end-2020 to €5.4bn. This compares with Q120 and Q119 sequential growth of 0.9% and 2.0%, respectively. Contrary to last year however, this was largely driven by working capital loans (€91m) followed by investment loans (€34m) and green loans (€33m). Having said that, we note that PCB classifies all loans with a maturity of up to three years as working capital loans. However, some of these may in fact be investment loans with a shorter maturity. We note that credit moratoria (ie deferrals of loan repayment) had a negligible impact on Q121 growth as these expired in several countries of PCB's operations in Q420. Consequently, only 2% of PCB's portfolio was under moratoria at end-December 2020 and less than 2% at end-March 2021.

Management highlighted that all ProCredit banks except Germany contributed to the loan book expansion with growth rates of 2% or more. All banks in the Southeastern Europe (SEE) segment grew their loan books by 2–4% during the quarter (particularly Romania and Albania), while in the Eastern Europe segment growth stood at 4.6% q-o-q, largely driven by positive fx effects (though constant currency growth was also positive). The loan book in Ecuador increased by 8.8%, in part due to the appreciation of the US dollar. PCB's green loan book grew by 3.4% versus end-2020 to c €1.0bn and now represents 18.8% of the total loan book (versus PCB's mid-term target of 20%). While the pace of growth was below previous quarters, management highlighted that it expects growth to again accelerate in the coming quarters.

At the same time, PCB continued to attract new deposits with Q121 growth of 2.5% (after an increase of c 13% in FY20), compared with a 1.7% decline in Q120. Similar to last year, the increase in deposits came mostly from sight and savings deposits, which together make up 69% of PCB's deposit base (up 5pp versus Q120). Interestingly, more than half of the Q121 growth (or €65m) came from private individual customers.

Cost of risk remains limited and below last year

Q121 loss allowances stood at €3.6m (versus €7.5m in Q420 and €6.9m in Q120), translating into an annualised cost of risk of 27bp. However, we note that this includes a €1.3m positive effect from the change in the allocation of interest accrual for loans in arrears for more than 90 days from net interest income to loss allowances from Q121 onwards. After adjusting for this, PCB's cost of risk was still relatively low at 37bp in Q121, below Q120 and FY20 level of 57bp.

Provisions in Q121 were primarily driven by stage 3 loans (€4.6m) and loan book growth (€1.8m). Consequently, the share of credit-impaired loans (stage 3 loans) in PCB's loan book increased slightly to 2.7% (from 2.6% at end-2020), while the share of stage 2 loans was down to 4.6%, from 4.9% at end-2020 (though there was an increase in restructuring processes). This is in line with our expectations that FY21 loss allowances will be mainly attributable to transfers from stage 2 to stage 3. On average, the credit quality of the green loan portfolio remains above the total loan book, though we note that there was an uptick in the default rate to 1.0% at end March 2021 from 0.6% at end 2020. PCB did not perform an update of its macroeconomic assumptions, given that the new International Monetary Fund's (IMF) forecasts released in April 2021 indicate a more moderate GDP contraction across PCB's countries of operations, but also a slightly lower rebound in 2021. We underline the continued strong recoveries of written off loans, which in Q121 stood at €3.2m (versus €11.2m in FY20). PCB's coverage of the impaired portfolio was down slightly to 88.9% at end March 2021 versus 91.4% at end 2020, but remains solid.

Net interest income affected by rate cuts and an accounting effect

PCB's net interest income was down 3.2% y-o-y to €49.3m in Q121, primarily due to the reduction in base interest rates in countries where PCB operates, as well as the €1.3m effect discussed above, which however was earnings neutral. As a result, Q121 NIM stood at 2.7% versus 3.1% in Q120 and 2.8% in Q420. We note however, that the NIM contraction was primarily visible in Ukraine, while other regional banks were largely able to offset the effect of rate cuts and reported a stable NIM y-o-y. Recently, NIM in Ukraine also stabilised and we note that the local central bank increased the base rate by 50bp in March 2021 and 100bp in April 2021 (from 6% to 7.5%), flagging that further rate hikes are likely given the high rate of inflation (8.4% in April 2021). Net interest income also declined versus end-2020 by c 3.0% (or €1.5m), which reflects the above-mentioned accounting effect, as well as a €1.1m calendar effect (lower number of days in the quarter). This was partially offset by loan book growth, with the net impact of loans and liabilities pricing remaining broadly neutral versus Q420.

Net fee and commission income was flat y-o-y at €12.0m in Q121 despite overall business growth, as customer transaction activity has not fully recovered to pre-COVID levels. Having said that, income from payment and card services went up versus Q120 by €0.5m, but was offset by lower account maintenance fees and higher fee and commission expenses.

Cost base under control assisted by PCB's lean branch network

Q121 CIR was 64.8% versus 64.6% in Q120, marginally below management's FY21 guidance of 65–68%. This is despite the above-mentioned change in interest accrual recognition having a 1.3pp negative impact on the ratio. Operating expenses decreased in Q121 by c 2.5% y-o-y to €40.7m, assisted primarily by c €0.8m of cost savings at PCB Romania (mostly due to last year's restructuring), as well as a €0.7m decline in travel expenses. This was only partially offset by provisions for legal expenses of €0.4m for litigations in Serbia booked by PCB in conjunction with the local supreme court ruling related to loan processing fees in the Serbian banking sector. PCB's management estimates that the total maximum risk associated with these litigations stands at €2.0m (which we estimate would have a minor €0.03 per share impact on PCB's value). Personnel expenses increased only slightly by 2% y-o-y to €21.0m despite an 8% headcount expansion across the group in FY20.

Capital ratios providing room for further growth

PCB's CET-1 ratio stood at 13.2% at end-March 2021, down slightly (by 5bp) from end-2020 due to loan book growth, which was partially offset by a c €50m reduction in the €87m excess liquidity placed in local central banks in Q420 amid strong deposit growth, as well as a slight improvement in translation reserves amid favourable fx changes in Q121**.** The ratio does not include PCB's H220 profits which will be recognised in the regulatory capital in Q221 (adding c 25bp) and that one-third of PCB's 2019 and 2020 profits (representing 46bp) was already deducted from the regulatory capital in line with management's dividend proposal and PCB's dividend policy. Management sees relatively limited impact from the implementation of Basel IV in 2023, given that PCB does not use internal models for the calculation of risk-weighted assets.

Forecast revisions

Given PCB's solid Q121 figures and the reiterated management guidance, we have made only minor changes to our net income forecasts, with the c 3% increase primarily being a function of reduced operating expenses assumptions, encouraged by PCB's good cost control, in particular the cost savings from restructuring in Romania.

Exhibit 2: Forecast revisions summary

€m, unless otherwise stated	2020	2021e				2022e			
	Actual	Old	New	Change	Growth y-o-y	Old	New	Change	Growth y-o-y
Net interest income	201.6	216.4	208.4	3.7%	3.4%	235.1	230.1	-2.1%	10.4%
NIM (annualised)	2.9%	2.8%	2.7%	-0.1 pp	-0.2 pp	2.8%	2.8%	-0.1 pp	0 pp
Expenses for loss allowances	(28.6)	(28.8)	(22.8)	-20.8%	N/M	(18.2)	(15.1)	-17.2%	-33.7%
Cost of risk (annualised in bp)	57	52	41	-11 bp	N/M	30	25	-5 bp	-16 bp
Net fee and commission income	47.4	51.3	51.0	-0.5%	7.6%	57.2	57.2	0.1%	12.2%
Pre-tax profit	52.1	64.8	66.2	2.1%	27.1%	90.2	93.2	3.3%	40.7%
Net income	**41.4**	**52.5**	**53.9**	**2.7%**	**30.3%**	**74.0**	**76.5**	**3.4%**	**42.0%**
CET1 ratio	13.3%	13.0%	13.0%	0 pp	-0.3 pp	12.9%	12.9%	0 pp	-0.1 pp
Total Capital Ratio (TCR)	14.7%	14.3%	14.3%	-0.1 pp	-0.4 pp	14.1%	14.1%	0 pp	-0.2 pp
CIR	68.0%	65.7%	66.5%	0.8 pp	-1.5 pp	63.8%	63.3%	-0.5 pp	-3.2 pp
Gross loan portfolio	5,254.3	5,805.5	5,816.3	0.2%	10.7%	6,378.3	6,383.0	0.1%	9.7%
Net loan portfolio	5,131.6	5,665.6	5,675.2	0.2%	10.6%	6,229.0	6,235.6	0.1%	9.9%
Customer deposits	4,898.9	5,469.6	5,518.3	0.9%	12.6%	5,986.8	6,037.9	0.9%	9.4%

Source: ProCredit, Edison Investment Research

In Q221, we expect PCB to post a net income of €13.2m (vs €8.0m in Q220), with a net interest margin of 2.7% (stable vs Q121), cost of risk at 43bp and a CIR at 66.2%.

Exhibit 3: Summary of Q221 results forecasts

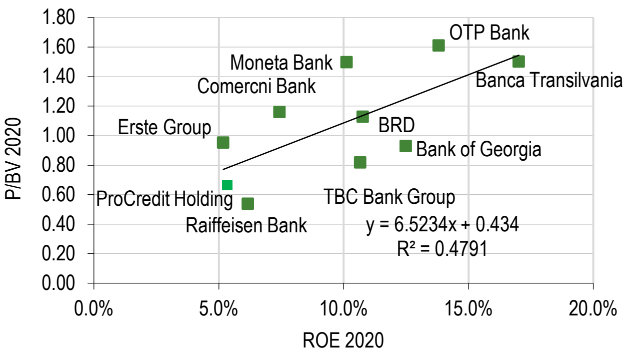
€m, unless otherwise stated	Q221	Q220	y-o-y change
Net interest income	51.8	49.0	5.7%
Net interest margin (annualized)	2.7%	2.9%	-18 bp
Expenses for loss allowances	5.8	8.8	-34.1%
Cost of risk (annualized, bp)	43	71	-29 bp
Net fee and commission income	12.2	10.6	14.8%
Pre-tax profit	16.3	10.1	61.7%
Net income	13.2	8.0	65.4%
CIR	66.2%	68.5%	-221 bp
CET-1 ratio	13.5%	14.1%	-0.6 pp
Gross loan portfolio growth (q-o-q)	1.6%	4.4%	-2.8 pp
Customer deposits growth (q-o-q)	1.9%	4.2%	-2.3 pp

Source: ProCredit, Edison Investment Research

Valuation

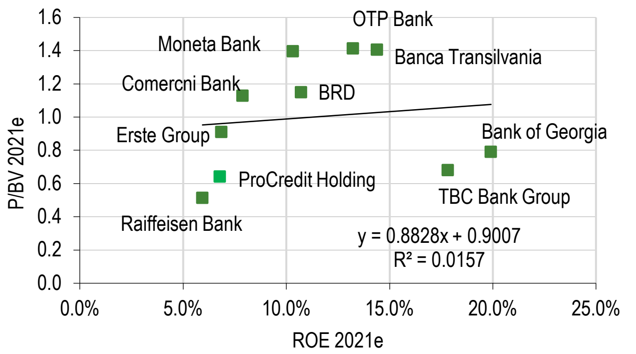
Our PCB fair value estimate remains at €11.20 per share, which currently implies c 28% upside potential. While PCB has one of the lowest FY20 ROEs in its peer group (5.3%), it also trades at one of the lowest price to book value (P/BV) ratios (0.7x) and as a result is positioned below the regression line in our P/BV-ROE landscape (see Exhibit 4). We note that the group is quite scattered across the P/BV-ROE map making the regression line somewhat less reliable. We believe this may be due to several non-financial factors, such as a different degree of political risk perceived by investors. We focus on FY20 numbers due to the low R-squared value of the regression line that is based on FY21e P/BV and ROE estimates for PCB and its peers, suggesting limited reliability (see Exhibit 5).

Exhibit 4: P/BV vs ROE – ProCredit and peers (2020)



Source: ProCredit, Edison Investment Research, Refinitiv

Exhibit 5: P/BV vs ROE – ProCredit and peers (2021)



Source: ProCredit, Edison Investment Research forecasts for PCB, Refinitiv consensus at 20 May 2021 for peers

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Exhibit 6: Financial summary

Year end 31 December (€000s)	FY18	FY19	FY20	FY21e	FY22e	FY23e	FY24e	FY25e
Income Statement								
Net interest income	186,235	194,533	201,561	208,412	230,094	252,425	276,151	304,195
Net fee and commission income	52,172	51,972	47,380	50,987	57,223	61,911	65,647	69,608
Loss allowances (-)	(4,714)	(3,327)	28,600	22,760	15,081	8,206	7,125	8,149
Operating income	245,394	252,603	223,514	242,909	279,888	315,476	344,811	376,681
Operating expenses	167,866	175,737	171,430	176,687	186,700	200,830	214,823	231,009
PBT	77,528	76,866	52,085	66,221	93,188	114,646	129,988	145,672
Net profit after tax	**54,479**	**54,305**	**41,396**	**53,923**	**76,549**	**94,638**	**107,666**	**120,987**
Reported EPS (€)	0.90	0.89	0.70	0.92	1.30	1.61	1.83	2.05
DPS (€)	0.30	0.00	0.53	0.31	0.43	0.54	0.61	0.68
Balance Sheet								
Cash and balances at Central Banks	963,714	1,081,723	1,405,349	1,529,980	1,606,998	1,725,544	1,813,171	1,937,047
Loans and advances to banks	211,592	320,737	236,519	239,071	239,071	239,071	239,071	239,071
Investment securities	297,308	378,281	336,476	339,673	339,673	339,673	339,673	339,673
Loans and advances to customers	4,267,829	4,690,961	5,131,582	5,675,159	6,235,578	6,858,019	7,552,547	8,322,822
Property, plant and equipment and investment properties	130,153	138,407	140,744	140,672	140,744	140,672	140,744	140,672
Intangible assets	22,191	20,345	19,316	19,334	19,316	19,334	19,316	19,334
Other assets	73,396	67,106	59,315	58,421	59,315	58,421	59,315	58,421
Total assets	**5,966,184**	**6,697,560**	**7,329,301**	8,002,310	8,640,695	9,380,734	10,163,837	11,057,041
Liabilities to banks	200,813	226,819	230,556	1,246,743	1,321,548	1,400,841	1,484,891	1,573,984
Liabilities to customers	3,825,938	4,333,436	4,898,897	5,518,325	6,037,905	6,614,955	7,252,463	7,956,899
Liabilities to international financial institutions	813,369	852,452	1,005,207	0	0	0	0	0
Debt securities	206,212	343,727	266,858	281,763	266,858	281,763	266,858	281,763
Subordinated debt	143,140	87,198	84,974	87,438	84,974	87,438	84,974	87,438
Other liabilities	33,076	50,436	63,080	60,045	63,080	60,045	63,080	60,045
Total liabilities	**5,222,549**	**5,894,068**	**6,549,573**	**7,194,314**	**7,774,364**	**8,445,041**	**9,152,266**	**9,960,130**
Total shareholders' equity	743,634	803,492	779,729	807,996	866,330	935,693	1,011,571	1,096,911
BVPS (€)	12.5	13.5	13.2	13.6	14.6	15.8	17.1	18.5
TNAV per share (€)	12.1	13.1	12.9	13.3	14.3	15.5	16.8	18.2
Ratios								
NIM	3.30%	3.10%	2.90%	2.72%	2.77%	2.80%	2.83%	2.87%
Costs/Income	69.7%	70.5%	68.0%	66.5%	63.3%	62.0%	61.0%	60.0%
ROAE	7.6%	6.9%	5.3%	6.8%	9.1%	10.5%	11.1%	11.5%
CET1 Ratio	14.4%	14.1%	13.3%	13.0%	12.9%	12.7%	12.6%	12.6%
Tier 1 ratio	14.4%	14.1%	13.3%	13.0%	12.9%	12.7%	12.6%	12.6%
Capital adequacy ratio	17.2%	15.7%	14.7%	14.3%	14.1%	13.7%	13.6%	13.5%
Payout ratio (%)	33.3%	0.0%	33.3%*	33.3%	33.3%	33.3%	33.3%	33.3%
Customer loans/Total assets	73.6%	71.6%	71.7%	72.7%	73.9%	74.7%	75.9%	76.7%
Loans/Deposits	114.8%	110.7%	107.3%	105.4%	105.7%	106.0%	106.3%	106.6%

Source: ProCredit accounts, Edison Investment Research. Note: *Management's dividend proposal reflects the intention to distribute one third of accumulated profits from 2019 and 2020.

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