ProCredit Holding

Q321 results

On track to reach its mid-term guidance

Banks

We now expect ProCredit Holding (PCB) to reach its mid-term ROE target of 10% in FY21, driven by continued scaling of its operations through consistent loan book expansion (we forecast 13% growth in FY21) while maintaining the high credit quality of its portfolio. The group has also benefitted from some recent net interest margin (NIM) expansion. Despite the above, it continues to trade at a significant discount to book value (current FY21 P/BV at 0.6x), which we find hard to justify.

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV (x)	P/E (x)	ROE (%)	Yield (%)
12/19	194.5	0.89	0.00	0.6	9.0	6.9	N/A
12/20	201.6	0.70	0.53	0.6	11.4	5.3	6.6
12/21e	219.5	1.37	0.46	0.6	5.8	9.9	5.7
12/22e	245.8	1.44	0.48	0.5	5.6	9.6	6.0

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

Q321 net income more than doubling versus Q320

PCB delivered a net income of €25.7m in Q321 compared to €11.7m in Q320, translating into an annualised ROE of 12.3% (10.1% based on 9M21 profit). Its loan portfolio growth was 2.6% q-o-q in Q321, bringing the growth in the year to date (ytd) to 10.4%. This was accompanied by a 5.0% q-o-q increase in deposits (7.6% ytd). PCB's cost of risk was 4bp in Q321 (vs 42bp in Q320) and the share of credit impaired loans remained stable versus end-2020 at 2.6%. It is also worth noting PCB's NIM improved to 3.0% in Q321 (vs 2.9% in Q320) and management considers this sustainable. We believe PCB's NIM may be supported if central bank interest rate hikes continue in a number of countries where PCB is present.

New mid-term guidance to be published next year

PCB aims at solidifying its ROE at around 10% in the near term through realising scaling effects from its tailored digital platform and lean branch structure, improving performance of weaker banks, the completion of key technology projects and conservative approach to credit risk management. Management is reviewing its mid-term targets and will communicate a new mid-term guidance on the publication of FY21 results in March 2022.

Valuation: Offering a c 84% upside potential

We have increased our fair value estimate of PCB to €14.70 per share from €12.60 previously on the back of higher FY21 forecasts, which translate into PCB's tangible book value forecast of €14.2 per share (versus €13.8 previously), and higher average FY21e P/BV of its peers (1.3x vs 1.2x previously). While we acknowledge the additional country risk associated with PCB's markets of operations (including lower COVID-19 vaccination rates vs Western Europe), we believe PCB's progress since the completion of its business streamlining in FY19 deserves to be recognized through its shares being traded closer to its book value.

19 November 2021

Price	**€8.00**
Market cap	**€471m**
Total assets (€bn) at end September 2021	7.9
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	1.3	5.8	33.3
Rel (local)	(3.4)	4.2	8.5
52-week high/low		€9.26	€5.90

Business description

ProCredit is a Germany-based group operating regional banks across South-Eastern and Eastern Europe and Ecuador. The banks focus on SMEs and private middle-income and high earners. At end-September 2021, the group's total assets stood at €7.9bn.

Next events

Deutsches Eigenkapitalforum	22–24 November 2021
EGM	8 December 2021

Analysts

Milosz Papst +44 (0)20 3077 5700

Anna Dziadkowiec +44 (0)20 3077 5700

financials@edisongroup.com

Edison profile page

ProCredit Holding is a research client of Edison Investment Research Limited

Q321 results: Ytd ROE in line with mid-term target

In Q321, PCB more than doubled its net income year-on-year to €25.7m versus €11.7m in Q320 and has beaten our expectations of €16.9m. This translates into an annualised ROE of 12.3% in Q321, bringing the ytd figure to 10.1% versus 5.6% in 9M20 and management's FY21 guidance of 8.0–9.5%. We also note the 9M21 ROE reached the company's mid-term target of c 10%.

Exhibit 1: Q321 highlights

€m, unless otherwise stated	Q321	Q321e	% diff	Q320	y-o-y change
Net interest income	58.2	55.2	5.4%	50.8	14.6%
NIM (annualised)	3.0%	2.9%	12 bp	2.9%	9 bp
Expenses for loss allowances	0.5	3.6	-85.6%	5.4	-90.7%
Cost of risk (annualised, bp)	4	26	-22 bp	42	-38 bp
Net fee and commission income	13.0	12.4	4.3%	12.1	7.4%
Pre-tax profit	30.3	20.5	47.9%	15.8	91.8%
Net income	**25.7**	**16.9**	**51.8%**	**11.7**	**119.7%**
CIR	59.0%	65.2%	-616 bp	66.7%	-766 bp
CET-1 ratio	13.8%	13.7%	7 bp	14.1%	-0.3 pp
Gross loan portfolio growth (q-o-q)	2.6%	2.9%	-33 bp	3.0%	-0.4 pp
Customer deposits growth (q-o-q)	5.0%	3.5%	150 bp	6.1%	-1.1 pp

Source: Company accounts, Edison Investment Research

Continuing to scale its business

PCB's gross loan book increased by 2.6% q-o-q in Q321 (vs our estimate of 2.9%), bringing the 9M21 growth to 10.4%, which is already in line with management's full-year guidance at c 10%. Having said that, we note management's loan book growth guidance excludes any currency impact while PCB's ytd growth has been partially assisted by positive fx effects (which added €100m to the ytd growth in loan book). According to the company, fx-adjusted growth in customer loans was 8.5% ytd, well on track to meet the full-year guidance.

Growth was supported by the performance of all PCB's regional banks and loan categories, but particularly strong momentum was recorded in working capital loans (54% of the nominal loan book increase in Q321), as SMEs were rebuilding capacity in the aftermath of COVID-19 lockdowns. We note that in this category, PCB recognises all loans with a maturity of up to three years, although some of them may be investment loans with shorter maturity. Green loans represented 19.0% of PCB's total loan book, which is already close to the mid-term target of 20%. At the same time, customer deposits went up by 5.0% q-o-q in Q321 (vs our estimate of 3.5%) with ytd growth at 7.6%. As a consequence of PCB's loan book slightly outgrowing the increase in deposits, PCB's loan to deposit ratio was down to 90.8% versus 93.2% at end-2020.

Maintaining good credit quality

The company continues to report a low annualised cost of risk at 4bp in Q321 (we assumed 26bp) versus 42bp in Q320, with expenses for loss allowances at €0.5m (Q320: 5.4m), largely attributable to growth in loan book. As a result, the annualised cost of risk stood at 8bp in 9M21. PCB also continues to report good recoveries of written-off loans at €2.6m. The share of credit impaired loans in total loan book were stable versus end-2020 at 2.6%, while the share of Stage 2 loans declined by 0.8pp to 4.1%. Management underlined that loan restructuring activities reduced significantly since mid-Q221 and the repayment level in the restructured portfolio is solid.

Importantly, PCB's loss provisions in 9M21 did not reflect any update to macroeconomic parameters despite the improving outlook in South-Eastern and Eastern Europe. The International Monetary Fund has raised its 2021 GDP forecast for emerging and developing Europe to 6.0% in its latest World Economic Outlook (published in October 2021) from 4.9% previously (July 2021, after an upward revision from 4.6% in April 2021) with the 2022 forecast unchanged at 3.6% (3.9%

in April 2021). However, given the risks around supply chain disruption, producer price inflation and rapidly increasing numbers of local COVID-19 cases (especially in the context of the share of fully vaccinated people at c 20–40% vs the EU average at c 65%), PCB's management does not expect any positive impact on the cost of risk from the revision of macroeconomic parameters in its FY21 results (while previously it estimated the potential provision release at c €4m).

NIM up on growth in loan volume and low-margin deposits

Net interest income was €58.2m (5.4% ahead of our estimate of €55.2m and up 14.6% y-o-y) with a NIM at 3.0% (vs our estimate at 2.9% and 2.9% reported in Q320). PCB's margin has been assisted by increasing loan volume (largely offsetting the base-rate cuts from last year) coupled with growing share of sight deposits and FlexSave deposits (69% at end-September 2021 vs 68% at end-June 2021). PCB's net fee and commission income improved 7.4% y-o-y to €13.0m (4.3% above our estimate of €12.4m), mostly on the back of further recovery in money transfer and credit/debit card volumes. As a result, it has returned to pre-pandemic levels (Q319 at €13.1m), while its gross fee and commission income exceeded Q319 levels. The latter was assisted by the expanding customer base and higher fees and commissions generated on existing clients.

Cost income ratio below 60%, capital base remains sound

PCB's cost income ratio (CIR) declined to 59.0% from 66.7% in Q320, translating into 62.4% in 9M21 (vs 66.5% in 9M20). This remains in line with FY21 guidance of c 65% (management now says CIR is 'likely to not exceed 65%'). This was assisted by positive margin development and scaling effects from PCB's loan book growth. As a result, the increase in income before loss allowances more than offset the moderate 5.0% y-o-y increase in operating costs to €44.4m. PCB's CIR continues to be supported by relatively limited travel expenses translating into c €2.6m savings vs 9M19 (or 1.3pp of PCB's CIR in 9M21). At the same time, personnel expenses increased 6.2% y-o-y in Q321, partially as a result of an annual salary review completed in July 2021. Following a revised verdict of the Serbian Supreme Court (in favour of banks), class actions against Serbian banks (including PCB Serbia) related to loan processing fees have come to a halt. Consequently, PCB has not accrued any further provisions since June 2021.

The group's capital base remains robust with a CET-1 ratio of 13.8% (up from 13.3% at end-2020) and total capital ratio of 15.0% (vs 14.7% at end-2020). The CET-1 ratio includes PCB's FY20 and H121 net profit, while the proposed dividend payment of €0.35 per share (€20.6m) was already fully deducted (reducing the ratio by 38bp). Moreover, one-third of the H121 net profit was deducted for the anticipated dividend for FY21. The CET-1 ratio was assisted by positive fx developments (which added 50bp), primarily from the appreciation of the Ukrainian Hryvnia and Georgian Lari. PCB has already paid a dividend of €0.18 per share this year and the management has proposed a further payout of €0.35 per share, which will be subject to shareholder vote at the next EGM in December 2021. The total dividend would be in line with PCB's policy of distributing one-third of profits to shareholders through dividends (this time based on combined FY19 and FY20 profits given, now payment was made last year).

Sustainable business model supported by impact orientation

PCB maintains its market position as an impact-oriented bank focused on building long-term relationships with well-established and innovative SMEs, which we believe has helped it navigate the pandemic well and keep credit default rates below the average level seen in its countries of operations. Its green loan portfolio grew at a CAGR of 26% between FY17 and FY20 and by c 12% ytd to €1.1bn in 9M21 (representing c 19% of PCB's loan book). These include loans to fund energy efficiency projects that reduce energy consumption by at least 20% (these made up 57% of the green loan portfolio at end-Q321) and renewable energy (20%) and other green investments (23%), including investments leading to the prevention of air, water and soil pollution, waste management, as well as organic agriculture and production. Environmental, social and governance assessment is central to all lending decisions in the group, supported by strict internal standards and experienced staff. PCB does not provide any meaningful consumer lending, which management highlights is the key differentiator from other banks in the countries where it is active.

PCB continues to promote staff development (eg it provides over 100 hours of training per employee per year on average) and equitable pay (eg management board salaries are less than four times the average salary in all banks and it does not pay contractual bonuses). Management highlights the diversity within PCB with 30+ nationalities in its German head office and c 50% of the group's senior and middle management being women. Noteworthy, PCB's internal environmental measures led to a 46% y-o-y reduction in the group's CO_2 emissions in 2020 and it continued investing in its own photovoltaic pharms, electric vehicles and efficient buildings. PCB provides a comprehensive overview of its sustainability-oriented strategy in its 2020 Impact Report.

Outlook and forecast revisions

Management maintained its FY21 guidance of c 10% loan portfolio growth, 8.0–9.5% ROE (expected to be at the upper end of the range), c 65% CIR, >13% CET1 and >9% leverage ratio, as well as a dividend payout at one-third of group profits. As discussed above, PCB's guidance in terms of loan book growth is at constant exchange rates, while the group recently benefitted from appreciation of local currencies versus euro as discussed above. As a result, we have pencilled in an FY21 loan book growth of 13.0% assuming end-2021 fx rates in line with current levels. PCB has seen an encouraging margin development recently and we note that a number of local central banks have raised their rates in Q321 and Q421 so far (including Georgia, Ukraine, Romania and Moldova). That said, we understand competitive pressure remains high and management expects its NIM to remain close to the recently reported level (3.0% in Q321) in the near term. Consequently, we have slightly increased our NIM assumptions to 2.9–3.0% in the coming years (vs our previous assumptions of 2.8–2.9%).

Management intends to solidify PCB's ROE of c 10% in FY22 and FY23 through further scaling effects from its tailored digital platform (developed by its in-house IT company Quipu) and lean branch structure; improving performance of weaker banks; completing its key technology projects (tech stack centralisation and digitalisation of all non-financial transactions); and continued low cost of risk on the back of its conservative approach to credit risk management. During the capital markets day in October, management highlighted that it sees room to further improve the ratio of loan book per employee in some of its regional banks, where it stands below the group average of c €2.3m per employee compared to more than €3.0m for some group banks such as ProCredit Bank Bulgaria. We forecast PCB's ROE at 9.9% in FY21 and 9.6% in FY22, with the small decline next year primarily attributable to our higher cost of risk assumptions versus FY21. We note PCB is already quite close to achieving its mid-term targets of CIR below 60% and ROE at 10%, while its loan book growth at constant currency has been in line with the 10% pa target. Management is reviewing PCB's targets and plans to release a new mid-term guidance on the publication of FY21 results in March 2022.

Exhibit 2: Forecast revisions

€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	215.3	219.5	*2.0%*	*8.9%*	235.9	245.8	*4.2%*	*12.0%*
NIM (annualised)	2.9%	2.8%	2.9%	*0 pp*	*0 pp*	2.8%	2.9%	*0.1 pp*	*0.1 pp*
Expenses for loss allowances	28.6	10.8	4.5	*-58.6%*	*N/M*	20.9	14.2	*-32.2%*	*218.1%*
Cost of risk (annualised in bp)	57	19	8	*-11 bp*	*N/M*	33	23	*-11 bp*	*15 bp*
Net fee and commission income	47.4	49.6	50.4	*1.6%*	*6.4%*	56.4	56.3	*-0.3%*	*11.6%*
Pre-tax profit	52.1	84.3	96.6	*14.6%*	*85.5%*	91.4	103.5	*13.2%*	*7.1%*
Net income	**41.4**	**70.0**	**81.0**	***15.7%***	***95.6%***	**75.5**	**85.1**	***12.7%***	***5.1%***
CET1 ratio	13.3%	13.2%	13.5%	*0.3 pp*	*0.3 pp*	13.0%	13.3%	*0.3 pp*	*-0.2 pp*
Total Capital Ratio (TCR)	14.7%	14.5%	14.7%	*0.3 pp*	*0 pp*	14.1%	14.4%	*0.3 pp*	*-0.3 pp*
CIR	68.0%	64.9%	63.5%	*-1.3 pp*	*-4.5 pp*	62.5%	61.9%	*-0.6 pp*	*-1.6 pp*
Gross loan portfolio	5,254.3	5,973.3	5,937.7	*-0.6%*	*13.0%*	6,562.0	6,522.3	*-0.6%*	*9.8%*
Net loan portfolio	5,131.6	5,842.2	5,805.1	*-0.6%*	*13.1%*	6,418.5	6,383.0	*-0.6%*	*10.0%*
Customer deposits	4,898.9	5,377.9	5,416.7	*0.7%*	*10.6%*	5,886.5	5,938.3	*0.9%*	*9.6%*

Source: ProCredit, Edison Investment Research

We expect PCB to post a Q421e net income of €18.9m vs Q420 at €8.0m, supported by a combination of higher net interest income (on the back of loan book growth and slightly higher NIM); visibly lower cost of risk; improving net fee and commission income; and the lack of significant one-offs similar to those the company booked in Q420.

Exhibit 3: Summary of Q421 results forecasts

€m, unless otherwise stated	Q421e	Q420	y-o-y change
Net interest income	58.1	50.8	14.4%
NIM (annualised)	2.9%	2.8%	11 bp
Expenses for loss allowances	1.2	7.5	-83.9%
Cost of risk (annualised, bp)	9	57	-85.0%
Net fee and commission income	13.4	12.7	5.5%
Pre-tax profit	23.1	10.2	125.8%
Net income	**18.9**	**8.0**	136.7%
CIR	66.6%	72.3%	-576 bp
CET-1 ratio	13.5%	13.3%	28 bp
Gross loan portfolio growth (q-o-q)	2.3%	0.9%	131 bp
Customer deposits growth (q-o-q)	2.7%	3.8%	-110 bp

Source: ProCredit, Edison Investment Research

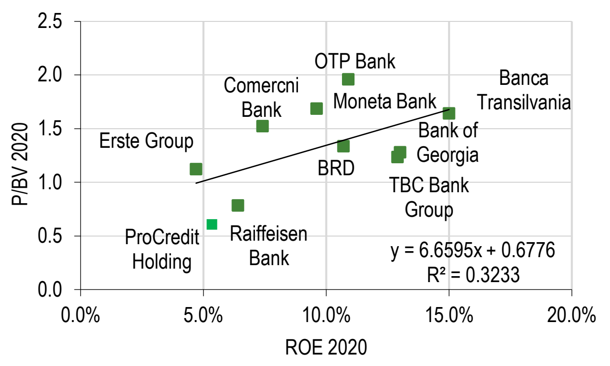
Valuation

Based on our FY21 forecasts for PCB, it is trading at the lowest FY21e P/BV ratio in its peer group at c 0.6x (versus the peer average of 1.3x based on Refinitiv consensus). Although our forecast FY21 ROE for PCB of 9.9% is below the peer group average (14.3%), we note it is broadly in line with two of its closest peers, Erste Group (10.1%) and Raiffeisen Bank International (9.3%), which trade at a FY21e P/BV ratio of 1.1x and 0.7x, respectively. The ytd share price performance for these two peers stands at c 61% and 70%, respectively (including a strong rally since July 2021), while PCB's shares appreciated by a mere 7% despite the improving results (the share price has fallen since July 2021).

A regression line based on FY21 P/BV and ROE estimates for PCB (Edison) and its peers (Refinitiv) implies an FY21 P/BV ratio for PCB of 1.16x. However, the R-squared value of this regression line is very low (see Exhibit 5). A similar comparison based on actual FY20 figures (with a visibly higher R-squared, see Exhibit 4) implies an FY21e P/BV ratio of 0.94x. Given we are well into FY21, we calculate the average of the above two ratios at 1.05x and blend this with the 1.04x ratio implied by the capital asset pricing model to arrive at a fair value multiple of 1.05x, which we use in our implied price to tangible book value method. Together with the upward revision of our FY21 forecasts highlighted above, this translates into our new PCB fair value estimate of €14.70

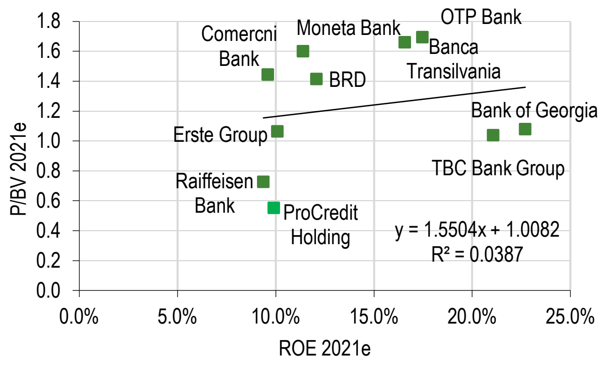
per share compared with €12.60 previously, representing a c 84% upside potential to PCB's current share price. Despite the additional risk associated with PCB's countries of operation (which we reflected in a higher blended equity risk premium of 8.7%), we believe PCB's shares should not trade at a discount to book value given the level of profitability.

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 19 November 2021 for peers

Exhibit 6: Financial summary

Year ending 31 December, €000s	2018	2019	2020	2021e	2022e	2023e	2024e	2025e
INCOME STATEMENT								
Net interest income	186,235	194,533	201,561	219,524	245,832	265,503	284,383	308,665
Net fee and commission income	52,172	51,972	47,380	50,424	56,292	61,557	65,653	69,291
Loss allowances (-)	(4,714)	(3,327)	28,600	4,454	14,170	11,212	10,071	8,258
Operating income	245,394	252,603	223,514	272,666	294,643	324,023	348,705	379,075
Operating expenses	167,866	175,737	171,430	176,029	191,145	203,075	217,316	232,593
PBT	**77,528**	**76,866**	**52,085**	**96,637**	**103,498**	**120,948**	**131,389**	**146,482**
Net profit after tax	54,479	54,305	41,396	80,966	85,094	99,982	108,753	121,501
Reported EPS	0.90	0.89	0.70	1.37	1.44	1.70	1.85	2.06
DPS	0.30	0.00	0.53	0.46	0.48	0.57	0.62	0.69
BALANCE SHEET								
Cash and balances at Central Banks	963,714	1,081,723	1,405,349	1,389,931	1,461,267	1,439,598	1,413,949	1,425,046
Loans and advances to banks	211,592	320,737	236,519	257,595	257,595	257,595	262,747	268,002
Investment securities	297,308	378,281	336,476	390,215	398,019	405,980	405,980	405,980
Loans and advances to customers	4,267,829	4,690,961	5,131,582	5,805,073	6,383,009	7,021,880	7,732,315	8,522,526
Property, plant and equipment and investment properties	130,153	138,407	140,744	136,947	136,947	136,947	136,947	136,947
Intangible assets	22,191	20,345	19,316	19,067	19,067	19,067	19,067	19,067
Other assets	73,396	67,106	59,315	54,439	54,439	54,439	54,439	54,439
Total assets	5,966,184	6,697,560	7,329,301	8,053,268	8,710,344	9,335,506	10,025,443	10,832,007
Liabilities to banks	1,014,182	1,079,271	1,235,763	1,290,773	1,368,220	1,340,855	1,314,038	1,327,179
Liabilities to customers	3,825,938	4,333,436	4,898,897	5,416,732	5,938,256	6,519,165	7,160,494	7,868,668
Debt securities	206,212	343,727	266,858	345,698	345,698	345,698	345,698	345,698
Subordinated debt	143,140	87,198	84,974	86,722	86,722	86,722	86,722	86,722
Other liabilities	33,076	50,436	63,080	58,788	58,788	58,788	58,788	58,788
Total liabilities	5,222,549	5,894,068	6,549,573	7,198,713	7,797,684	8,351,229	8,965,740	9,687,054
Total shareholders' equity	743,634	803,492	779,728	854,554	912,660	984,277	1,059,703	1,144,953
BVPS	12.5	13.5	13.2	14.5	15.5	16.7	18.0	19.4
TNAV per share	12.1	13.1	12.9	14.2	15.2	16.4	17.7	19.1
Ratios								
NIM	3.30%	3.10%	2.90%	2.85%	2.93%	2.94%	2.94%	2.96%
Costs/Income	69.7%	70.5%	68.0%	63.5%	61.9%	60.6%	60.6%	60.0%
ROAE	7.6%	6.9%	5.3%	9.9%	9.6%	10.5%	10.6%	11.0%
CET1 Ratio	14.4%	14.1%	13.3%	13.5%	13.3%	13.2%	13.3%	13.3%
Tier 1 ratio	14.4%	14.1%	13.3%	13.5%	13.3%	13.2%	13.3%	13.3%
Capital adequacy ratio	17.2%	15.7%	14.7%	14.7%	14.4%	14.2%	14.2%	14.1%
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%	73.7%	74.9%	76.8%	78.7%	80.2%
Loans/Deposits	114.8%	110.7%	107.3%	109.6%	109.8%	110.0%	110.1%	110.3%

Source: Company data, Edison Investment Research

General disclaimer and copyright

Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia