ProCredit Holding

Company outlook

Raising its mid-term targets

Banks

ProCredit Holding's (PCB's) new mid-term outlook is targeting a return on equity (ROE) of c 12% (previously 10%). We believe this is achievable for several reasons. Loan book growth should help realise further scaling effects. PCB's net interest margin (NIM) should benefit from higher base rates and an improving deposit to loan ratio. The above should assist a further reduction in the cost-income ratio, with PCB's mid-term target at c 57% versus 64% in FY22. We also expect PCB to sustain its good credit quality (25–30bp cost of risk over the cycle), while profitability should be assisted by improved risk-weighted assets density and a stabilisation at ProCredit Bank Ukraine.

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV (x)	P/E* (x)	ROE (%)
12/21	222.0	1.35	0.00	0.43	4.6	9.7
12/22	264.6	0.28	0.00	0.42	22.1	1.9
12/23e	295.5	1.27	0.42	0.39	4.9	8.3
12/24e	303.3	1.68	0.56	0.36	3.7	10.1

Note: *EPS as reported by the company.

ROE of 6–8% guided for FY23e

Despite the high loan loss provisions of €104.6m in FY22 (from €6.5m in FY21), mostly related to Ukraine, PCB achieved a positive ROE of 1.9% (7.8% excluding Ukraine). PCB's management is assuming a cost of risk of up to 70bp in FY23, of which around half may come from Ukraine, where the company already has a high provisioning level covering 16% of the total local loan book and 130% of the default portfolio at end-2022 (the share of credit-impaired loans as at end-2022 in Ukraine was 11.9%). Management therefore expects an FY23e ROE of 6–8% (we expect it to reach the upper end of the range), assisted by a continued strong NIM (despite a likely gradual re-pricing of deposits), with the Q422 level of 3.3% being a good run-rate for the coming quarters.

Focus on improving the deposit to loan ratio

PCB recently shifted its focus from high loan book growth (now guided at a medium to high single-digit percentage per annum in the medium term, versus the 2017–22 average of 9.3% pa) to improvements in profitability and the deposit to loan ratio. The latter was up at group level from 93.5% at end-2021 to 103.0% at end-2022, as deposit growth of 13.5% y-o-y outpaced loan book growth of 3.1% y-o-y (partly due to a reduction in Ukrainian loans). PCB's mid-term ambition is to move the average ratio at group level closer to c 115–120% (and for all regional banks to be above 100%).

Valuation: Offering a c 68% upside potential

In our base case scenario (which assumes a sustainable return on tangible equity (RoTE) of 10%), we value the business at €10.36 per share, slightly below our previous valuation of €10.80 due to updated country risk premiums. Assuming an RoTE in line with management's mid-term guidance (12%), PCB would be valued at €12.08/share. Finally, in a worst-case scenario of full write-off of the local bank in Ukraine, we would value PCB at €9.08 per share.

27 April 2023

Price	**€6.18**
Market cap	**€364m**
Total assets (€m) at end-2022	8.8
Shares in issue	58.9m
Free float	42.3%
Code	PCZ
Primary exchange	Frankfurt Prime Standard
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	13.2	18.4	69.3
Rel (local)	7.2	13.4	47.5
52-week high/low		€7.14	€2.56

Business description

Based in Germany, ProCredit Holding operates regional banks across South Eastern and Eastern Europe and Ecuador. The banks focus on SMEs and private middle-income and high earners.

Next events

Q123 results	15 May 2023
Equity Forum German Spring Conference	16–17 May 2023

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Edison profile page

ProCredit Holding is a research client of Edison Investment Research Limited

Investment summary

Company description: Impact-oriented SME lender

PCB is a specialist SME lender operating in emerging Europe and Ecuador, with a strong emphasis on sustainability and long-term relationships with its customers. It completed an important streamlining of the business before the pandemic, involving the reduction of its branch network and the digitalisation of operations (powered by in-house software company Quipu), which helped it withstand the impact of COVID-19 (and more recently the war in Ukraine). The company's sustainability orientation is also illustrated by its growing portfolio of green loans of €1.2bn at end-2022, representing c 20.2% of its total loan book (it recently raised the mid-term target from 20% to 25%).

Financials: Mid-term ROE target of 12% looks achievable

PCB's management recently published its updated mid-term guidance targeting a 12% ROE (previously 10%), based on a 25–30bp cost of risk over the cycle. Management also aims to reduce its cost to income ratio (CIR) to c 57% and for loan book growth in the medium to high single-digit percentage range per annum. We consider these targets achievable; our current forecasts assume a slightly more conservative ROE of 11.5% and a CIR of 59% in FY27e. Meanwhile, PCB expects an ROE of 6–8% in FY23 (we assume the upper end of the range) with a cost of risk of up to 70bp (of which management expects roughly half to come from Ukraine).

Valuation: Upside potential of 68% despite the recent rally

Since our last outlook note in July 2022, PCB's share price has increased by c 77%, which we believe confirms our conclusion at that time that the market had overreacted to the outbreak of the war in Ukraine. In our base case scenario, we assume a moderate positive mid-term impact of ProCredit Bank Ukraine on group results and we value PCB at €10.36 per share (from €10.80). While we reflect PCB's improving mid-term earnings prospects in our forecasts, we have conservatively decided to retain our previous sustainable RoTE assumption of 10.0%. Moreover, our revised fair value estimate reflects our updated country risk premiums, bringing the price to tangible book value (P/BV) implied by the capital asset pricing model (CAPM) to 0.73x (previously 0.77x). We blend this with the ratio implied by the P/BV-ROE regression of PCB's peers for FY23e of 0.71x (0.70x in our November 2022 note). If we assume a sustainable RoTE of 12% (in line with management's mid-term target), this would yield a fair value of €12.08 per share.

Sensitivities: Ukraine and a global economic hard landing

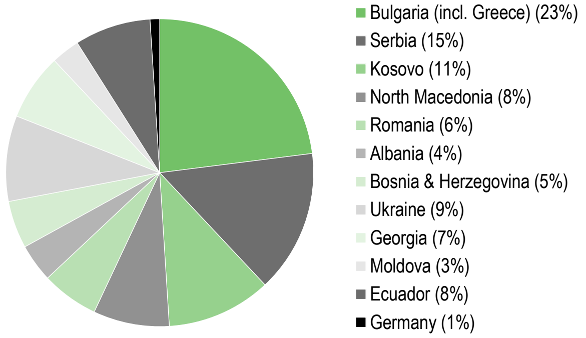
The key risk to our forecasts is the prospective development of the war in Ukraine. In a bear case scenario in which we assume a default of ProCredit Bank Ukraine, we arrive at a fair value of €9.08 per share (based on an RoTE of 10%). Moreover, while PCB considers the default risk of ProCredit Bank Ukraine as low at present, it recently reduced the liquidity risks associated with the potential default of the regional bank on the group by amending the cross-default clauses in some of its debt agreements to exclude ProCredit Bank Ukraine until 2024, in exchange for an annual fee of 0.5%. Out of the creditors approached (representing a nominal debt volume of €289.5m), those accounting for €221m agreed to this change. On the other hand, PCB's management sees ROE upside potential of 1.0–1.5pp in a Ukraine reconstruction scenario.

The risk of a recession in Europe represents another major sensitivity. We estimate that every 100bp deterioration in PCB's sustainable RoTE due to the long-lasting effects of a global recession would reduce our valuation by c €0.87 per share. PCB has no direct exposure to Russia and thus the sanctions imposed on the country have no direct or meaningful impact on PCB's business.

Company description: 'Hausbank' for SMEs

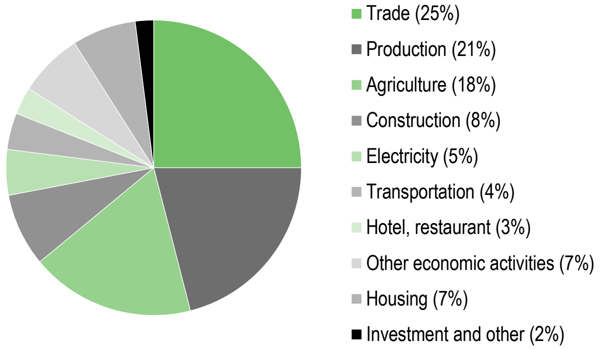
PCB specialises in financing SMEs in transition economies, currently in emerging Europe – South-Eastern (SEE) and Eastern Europe (EE) – and Ecuador (see Exhibit 1), while its German operations are largely focused on providing services to the group such as efficient payment, liquidity and support functions. PCB's focus is on impact-oriented financing, which supports sustainable development, employment and social prosperity. Its target customer group is growing, well-established SMEs (with a target loan size from €50k to €1.5m) that foster innovation, local production and the transition to a green economy (SMEs represented 91% of PCB's gross loan book at end-2022). PCB also offers banking services to private clients, mostly to middle-income and high earners (SME owners in particular). It provides a full range of banking services, including investment and working capital loans, as well as liquidity management and trade finance. It also offers housing and investment loans and overdrafts to private clients as well as current accounts, flexible savings and term deposit accounts.

Exhibit 1: PCB's loan book by country at end-2022



Source: ProCredit data

Exhibit 2: PCB's loan book by sector at end-2022



Source: ProCredit data

Highly digitalised operations

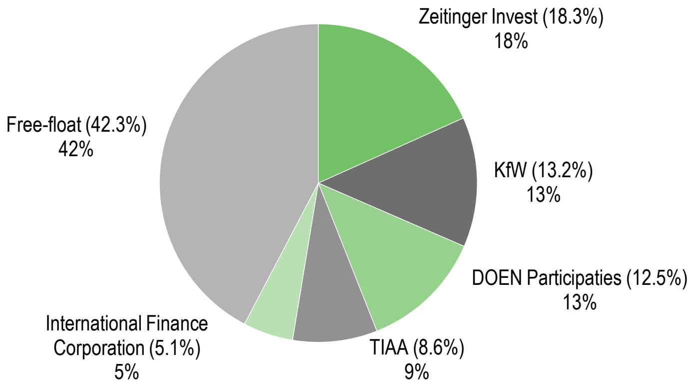
Despite its traditional approach to banking, PCB is committed to investing in the development of efficient and secure technology. Its app- and web-based functionalities are developed in house by Quipu, which PCB believes helps address IT challenges quickly. The launch of ProCredit Direct in 2017, a digital banking platform primarily for private clients, complemented the existing approach of Hausbank for SMEs (involving a comprehensive approach to SME companies) and allowed the company to initiate the digitalisation of financial services to private clients, fully completed in 2018. All transactions in the group's banks are now digital (PCB abolished over-the-counter and cash transactions in its branches).

High-profile core shareholders in PCB's register

We believe that PCB's holistic approach to sustainability issues, which is well-rooted in its history and mission, is supported by its shareholder structure. PCB's core shareholders currently include Zeitinger Invest (a strategic shareholder since inception, 17.0% stake), KfW (a German development bank, 13.2%), DOEN Participaties (a Dutch entity focused on supporting sustainable and socially inclusive entrepreneurs, 12.5%) and the International Finance Corporation (IFC, a member of the World Bank Group, 5.1%). PCB's shareholder base also includes the Teachers Insurance and Annuity Association of America (TIAA), which holds an 8.6% stake.

In March 2023, PCB announced that the European Bank for Reconstruction and Development (EBRD) will purchase the 5.06% stake currently held by the IFC and upon completion of the transaction will replace IFC as a core shareholder with an 8.7% stake (EBRD has held a 3.6% minority stake since 2018). We believe that having EBRD as a major shareholder should further support PCB's business in the SEE and EE region given EBRD's regional focus and emphasis on funding climate change and SMEs. PCB has already been participating in EBRD programmes in all of its countries of operation in the region.

Exhibit 3: PCB's shareholder structure



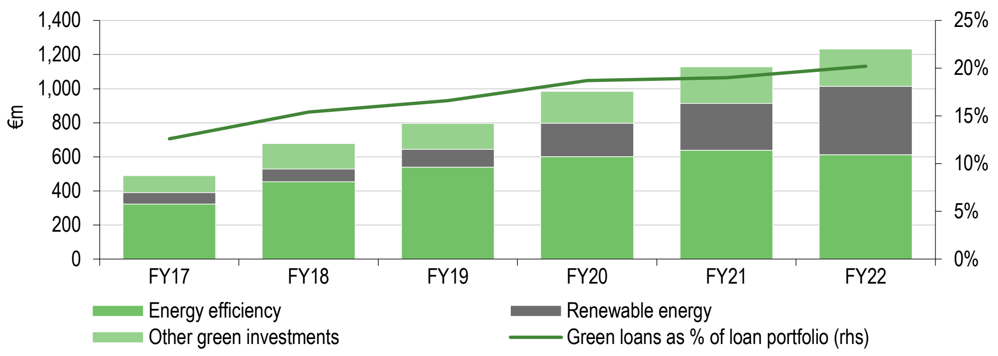
Source: ProCredit data as presented in April 2023. Note: Excludes EBRD until publication of the voting right notification.

Sustainability orientation

PCB's long-term mission is to contribute to an inclusive, stable and efficient financial system. It focuses on building and maintaining long-term relationships with its clients and employees, offers simple and transparent products, promotes a savings-oriented culture and puts a strong emphasis on prudent credit as well as environmental and social risk management. Moreover, PCB has been actively cooperating with European institutions to foster innovation and became one of the largest partners of the InnovFin programme run by the European Investment Fund. PCB highlights that it can fulfil the needs of SMEs better than its competitors, thanks to its well-trained and long-serving staff (see our last ESG Edge report for details).

PCB's sustainability orientation is also illustrated by its growing book of green loans. Its €1.2bn green loan portfolio represented c 20.2% of its loan book at end-2022, the highest among its competitors in local markets, according to management, and growing at a CAGR of 13% between FY18 and FY22. Management declared a new medium-term target for the share in green loans in the total loan book of 25%. Its green portfolio includes loans to fund energy efficiency projects that reduce energy consumption by at least 20% (these made up 50% of the green loan portfolio at end-FY22), renewable energy (33%) and other green investments (18%), including investments leading to the prevention of air, water and soil pollution, waste management and organic agriculture and production (see Exhibit 4). We note that PCB operates in countries where CO_2 emissions per unit of GDP are still higher than the EU average, which we believe creates scope for further growth in its green loan book.

Exhibit 4: PCB's green loan book



Source: ProCredit data

PCB's ESG efforts are also reflected in its MSCI ESG rating of AA (last updated in June 2022) and its outperformance versus peers in our ESG scoring system (see our ESG Edge report for details).

Management

PCB's business is managed by ProCredit General Partner (the personally liable managing partner of ProCredit AG & Co KGaA), which has a management board consisting of four members:

- **Hubert Spechtenhauser** joined in March 2022 and became the first chairman of the management board. He has held various senior managerial positions at Commerzbank Group, Landesbank Hessen-Thüringen (Helaba) Group and UniCredit Group. At ProCredit, he is responsible for legal aspects, group communication and internal audit.
- **Christian Dagrosa** joined ProCredit Holding in 2017 and between 2019 and 2022 was an authorised representative of the company ('prokurist') and manager responsible for investor relations, as well as reporting and controlling. He is currently the board member responsible for accounting and taxes, supervisory reporting and capital planning, group funding and treasury, controlling, reporting and data management, investor relations, as well as administration and translation.
- **Dr Gian Marco Felice** joined the management board in June 2020. He has held various managerial positions within the group since 2001 and is now responsible for business support, environmental management and impact reporting, as well as IT.
- **Sandrine Massiani** joined PCB in 2007 and initially worked as regional coordinator in Africa. She became coordinator of the group's human resources in 2011, and manager of human resources and IT in 2015. She was appointed to the management board in 2017 and is currently overseeing credit, financial and operational risk management and risk control, fraud prevention, compliance and anti-money laundering, as well as human resources. Before joining PCB, Sandrine worked at BNP Paribas and Development Finance International (an international advisory firm focused on emerging markets) and was a project coordinator and short-term expert at Internationale Projekt Consult.

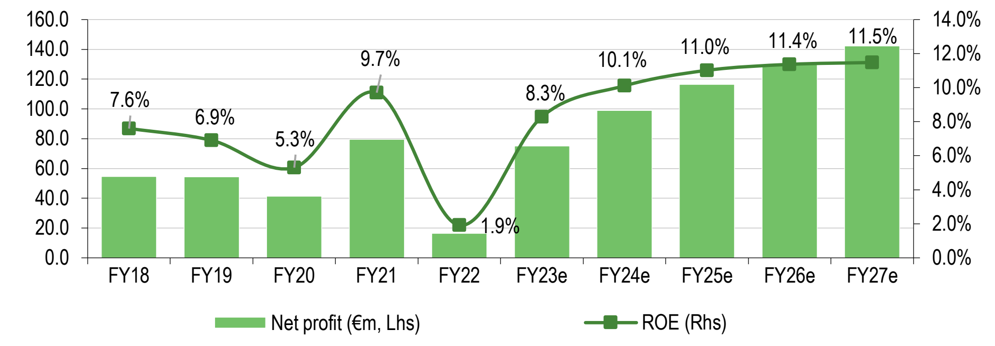
PCB's management is supported by two authorised representatives: **Rossana Mazzilli**, chief legal counsel, and **Martin Godemann**, head of group funding.

In October 2022, ProCredit General Partners agreed with PCB's shareholders to prepare a change of ProCredit Holding's legal form into a stock corporation. The general partner believes that the change will provide a greater alignment with ProCredit Holding as an internationally oriented, listed financial holding company and offers the opportunity to realise efficiencies in its corporate governance structure and the work of the company's executive bodies. PCB's management will seek shareholder approval at the 2023 AGM or, if this timeline cannot be met, at the AGM in 2024.

New target ROE: 12% in the medium term

PCB group's historical average ROE of 8–9% since 2005 was somewhat below its Austrian peers (Raiffeisen Bank International (RBI) and Erste Group), OTP Group and NLB Bank at c 10–14% and local players at c 15–25% (although this is in local currencies and therefore subject to foreign exchange (fx) risk for international investors). At the same time, PCB's returns were very stable, as it has remained profitable every year since 2005, even during the global financial crisis in 2008–09 with an ROE at c 4% and amid last year's war in Ukraine with a return of c 2% (see Exhibit 5).

Exhibit 5: PCB's historical and forecast ROE

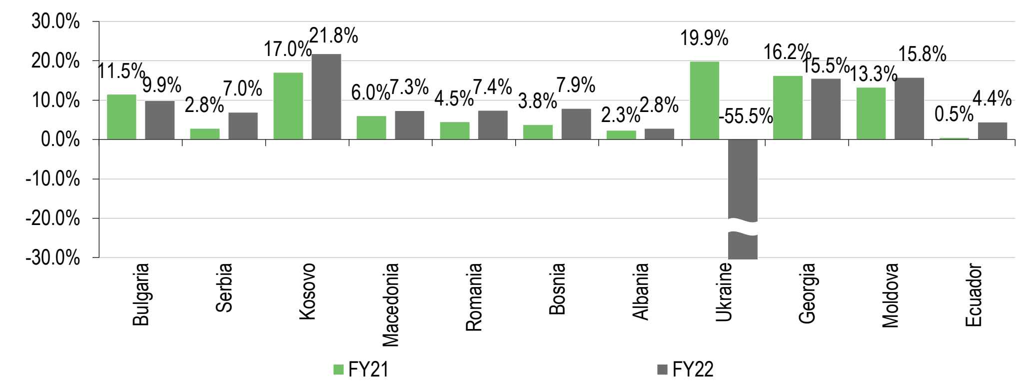


Source: ProCredit data, Edison Investment Research

Management's new mid-term target (usually covering the next three to five years) assumes an ROE of c 12% (previously 10%), with its FY23 guidance somewhat lower at 6–8% (mostly due to the still elevated cost of risk). This compares with FY22 and FY21 ROEs excluding Ukraine at 7.8% and 6.9% respectively (1.9% and 9.7% including Ukraine respectively) and FY23 guidance of PCB's major peers of 13–15% (Erste Group) and 10% (RBI, 7% excluding Russia and Ukraine).

Management noted that the increase in ROE at group level should be driven by the improvement of some of the less profitable banks. There is a significant disparity in terms of ROE across the regional banks, as illustrated in Exhibit 6.

Exhibit 6: ROE of PCB's regional banks



Source: ProCredit data

A good success story is the improvement of ProCredit Bank Bosnia, where ROE increased from negative 3.0% in 2019 to 7.9% in 2022 as its CIR reduced from 100% to 62%, assisted by a 70bp increase in average income on the loan book to 4.7%, a 60bp reduction in funding costs and a 52pp increase in the deposits to loans ratio. Below we outline the key potential catalysts for improving PCB's ROE over the medium term.

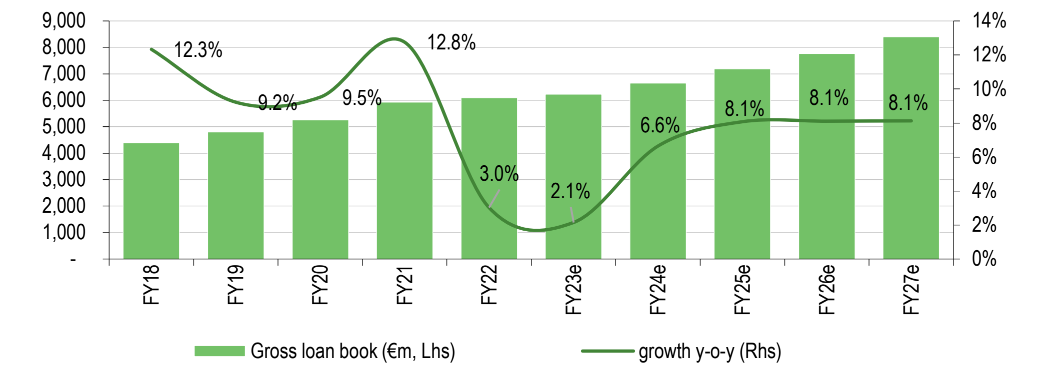
Catalyst #1: Realising scale through loan book growth

PCB's management believes that its local banks in Bulgaria and Kosovo have already reached a stage at which they can generate sustainable over-the-cycle ROE of c 11–12% and 12–15% respectively (versus 9.9% and 21.8% respectively in FY22). Meanwhile, PCB is further scaling some of its other regional banks, most notably in Romania, Bosnia and Albania (with positive effects already materialising in Romania and Bosnia in FY22).

That said, PCB's focus has shifted from high loan book growth at a group level (which averaged 9.3% pa in 2017–2022) to improvements to profitability and the deposit/loan ratio (see below). Together with the more muted global economic outlook and further targeted loan book reduction in Ukraine, this translates into PCB's management guidance of loan book growth of medium to high single-digit percentage pa, with medium single-digit percentage growth (excluding fx) guided for FY23 (we expect the group loan book to grow by c 2% in FY23 and by an average 7.7% pa in FY24–27).

Loan portfolio growth should be supported by PCB's focus on providing a tailored, comprehensive service to SMEs, especially loans below €1.5m, which may not receive the same level of attention at other banks operating in the region. Green loans should also represent a significant growth driver (with more than 50% of loan growth in FY22 driven by this loan category, which increased by 9.1% y-o-y). The ongoing energy crisis constitutes a strong catalyst, especially for renewable energy loans, which PCB expects to represent 50% of the green loan book in the medium term versus 33% in FY22. Based on our discussion with management, we understand that the bottlenecks associated with the discontinuation of providing funding for solar panels produced in the Xinjiang province in China (due to concerns over Uyghur forced labour) are gradually being resolved as the solar panel supplier base of PCB's borrowers diversifies.

Exhibit 7: PCB's historical and forecast loan book growth



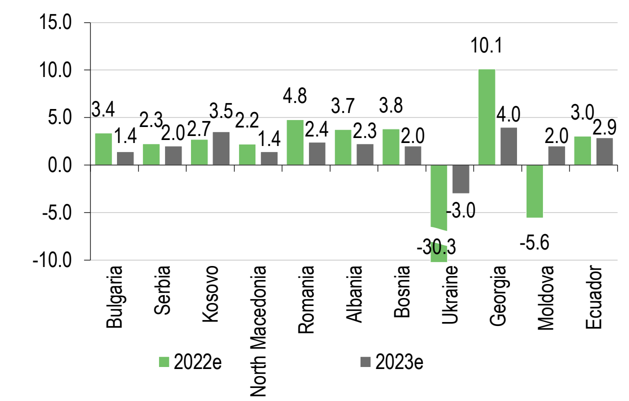
Source: ProCredit data, Edison Investment Research

In its recent World Economic Outlook report released in April 2023, the IMF expects real GDP growth across PCB's countries of operation of 1.5–4.0% in 2023 (except for Ukraine where GDP is forecast to contract by 3%). Despite the near-term slowdown, these countries are well positioned to continue to outpace economic growth in the euro area, with 2024–28 growth expected at c 3–5% pa (see Exhibit 9), providing mid-term growth tailwinds for PCB.

The economic outlook for Ecuador remains mixed, as high oil prices continue to be supportive for the country as an oil exporter, but political risks (including the impeachment trial its current president will face in May) and tighter financing conditions for emerging markets in general may influence the country's ability to return to international financial markets (which the IMF assumes in

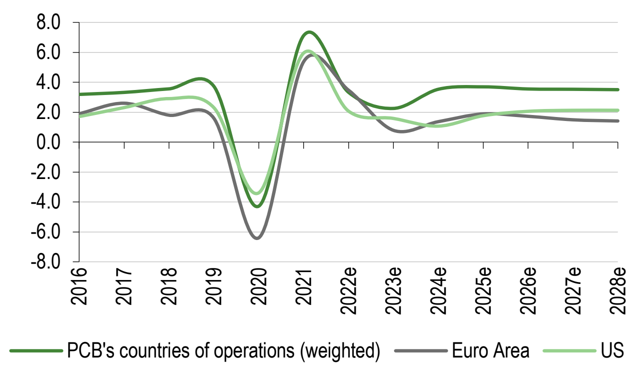
2024 in its base scenario disclosed in its country report on Ecuador in December 2022). We note that Ecuador's five-year credit default swaps are currently priced at c 3,450bp compared to c 900bp a year ago. That said, we note that Ecuador recently completed its first IMF programme in more than two decades and signed a new agreement with the IMF covering an additional SDR497m (c US$700m) in funding that the country can utilise.

Exhibit 8: Real GDP forecasts in 2022 and 2023 in PCB's countries of operation



Source: IMF World Economic Outlook April 2023 database.

Exhibit 9: Average real GDP growth of PCB's countries of operation compared to the euro area and the US



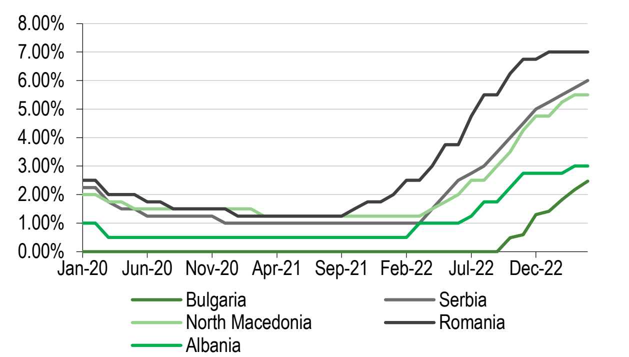
Source: Edison Investment Research based on data from the IMF World Economic Outlook April 2023 database. Note: Weighted average based on share of PCB's loan book in the relevant year (2022 share for 2023–28e). Forecasts exclude Ukraine.

Moreover, growth of the local banking sectors should be assisted by still low penetration rates (calculated as loan book to 2021 GDP) of 0.5x in SEE/EE (excluding Ukraine) versus 0.9x in Central and Eastern Europe and 1.5x in Western Europe, according to PCB.

Catalyst #2: NIM supported by higher base rates and improving deposit/loan ratio

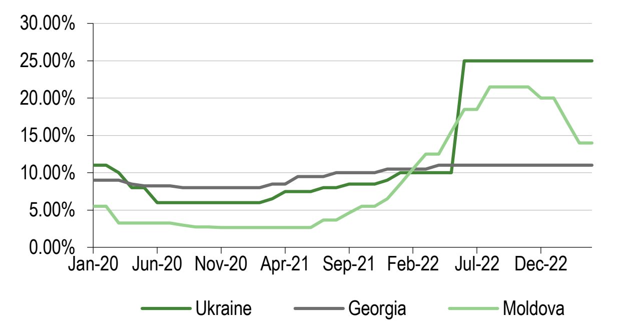
Base rate hikes across PCB's countries of operation last year (see Exhibits 10 and 11) provided a solid tailwind to PCB's NIM, which increased to 3.1% in FY22 from 2.9% in FY21. Management considers the Q422 NIM of 3.3% a good run-rate for the next few quarters, though expects it to moderate towards the end of the year as deposit rates are repriced.

Exhibit 10: Central bank policy rates in the SEE region



Source: Local central banks

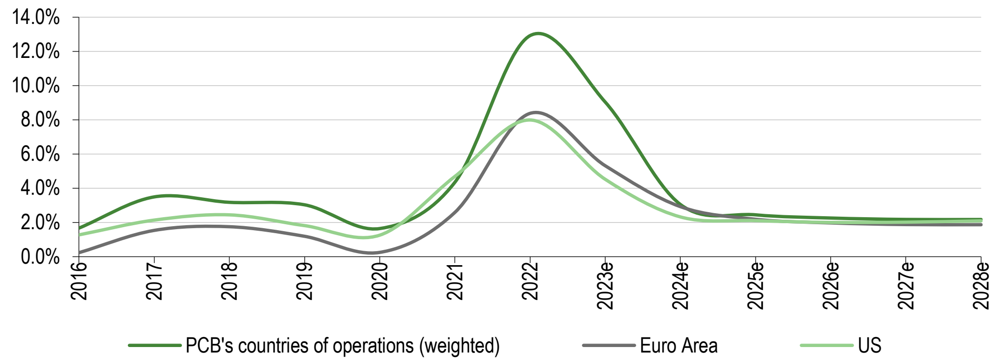
Exhibit 11: Central bank policy rates in the EE region



Source: Local central banks

We think that monetary easing across the region is unlikely in the coming quarters, even as the IMF expects inflation to gradually come down from the 2022 peak (see Exhibit 12), when inflation in all countries where PCB operates was in high single digits or (more often) double digits. An exception here is Ecuador, which we understand is partly due to the dollarisation of the economy limiting currency risk and anchoring inflation. Disinflation should be assisted by monetary tightening, easing supply chain bottlenecks and slowing growth.

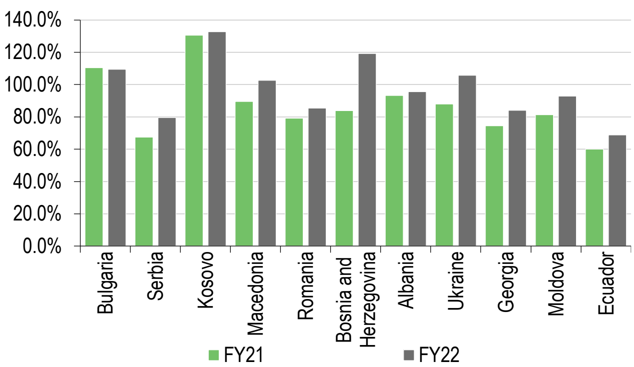
Exhibit 12: Average inflation rate of PCB's countries of operation versus the euro area and US



Source: Edison Investment Research based on data from the IMF World Economic Outlook April 2023 database. Note: Weighted average based on the share of PCB's loan book in the relevant year (2022 share of 2023– 28e). Forecasts exclude Ukraine.

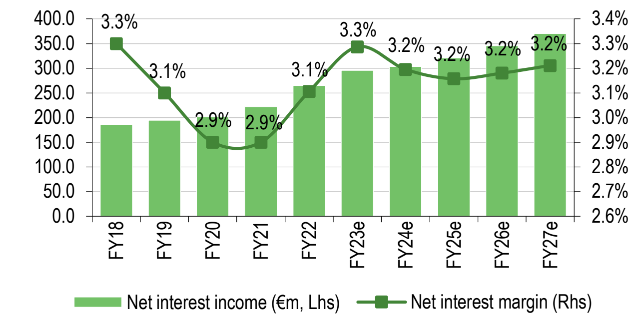
Deposit costs remained quite low in FY22 (eg 0.3% in SEE on average versus the 1.8% average cost of non-customer funding), but started increasing in late 2022 with the Q422 cost up c 20bp y-o-y. This may be at least partly offset by an improving funding mix, with PCB's deposit to loan ratio up to 103.0% at end-2022 from 93.5% at end-2021 as deposit growth of 13.5% y-o-y (driven equally by retail and SME customers) was ahead of loan book growth (3.1% y-o-y). While the reduction in the Ukrainian loan book was one of the contributing factors, we note that the improvement in the deposit to loan ratio in FY22 was seen across all countries of operation (except Bulgaria), see Exhibit 13. PCB's management highlighted that it did not experience any elevated deposit outflows in the wake of the Silicon Valley Bank collapse. We understand that PCB's mid-term ambition is to move the average ratio at group level closer to c 115–120% (and for all regional banks to reach a ratio above 100%). In the context of interest rate sensitivities, we note that the average maturity of bonds that PCB holds in its books as investments is below one year.

Exhibit 13: Deposit to loan ratio of PCB's regional banks



Source: ProCredit data

Exhibit 14: PCB's historical and forecast net interest income and NIM



Source: ProCredit data, Edison Investment Research

We believe that PCB's deposit growth should be supported by (1) its 'Hausbank' approach to SMEs (ie focus on providing a comprehensive banking experience to its clients), (2) its direct banking platform, and (3) the fact that money markets are likely less developed in its countries of operation than in Western countries (the United States in particular), being thus a less important competitor for bank deposits. In this context, we note that PCB has grown its deposit base by c 13% in each year since 2019.

PCB assumes that its fee and commission income will remain stable as a percentage of operating income at 16%, with key drivers being new non-loan clients, growth in income from private individuals and the expansion of trade finance.

Catalyst #3: Cost control aimed at a reduction in CIR to 57%

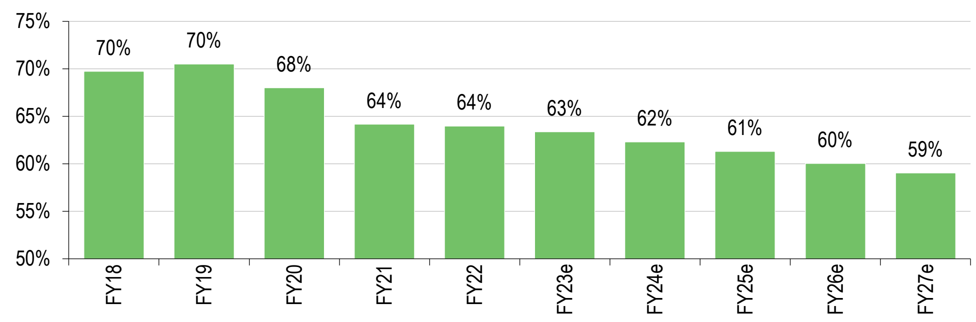
PCB's CIR reached 64.0% in FY22, close to the 64.2% achieved in FY21 and slightly behind the updated management guidance of 60–63%. That said, the ratio includes c €13.7m of one-off expenses (including €11.8m related to Russia's invasion of Ukraine) and €3.5m of one-time positive effects from the valuation of derivatives; adjusting for these, PCB's CIR was 60.8% in FY22 (close to its previous mid-term target of below 60%).

PCB's management has set the new mid-term target at 57% (excluding one-off effects), while expecting FY23 to be broadly in line with FY22 (±1%). While PCB's management believes there is still potential to increase the loan book per employee ratio at some of its regional banks, it intends to keep the number of loan clients per business client advisor at no more than 50 (normally 40–50 clients). Consequently, after a c 8% increase in the year-end number of employees in FY22 (to build a headcount reserve for subsequent training), management expects group headcount to moderately increase in FY23 by a single-digit percentage rate and then flatten out for a year or two.

Management admitted that talent acquisition remains difficult in the current environment and is putting pressure on wage growth. We calculate that average salary and social security expenses per employee increased by c 9.5% y-o-y in FY22, though this likely includes some one-time payments (eg to Ukrainian staff). The above pressure is partially mitigated by PCB's solid image as an employer (with a limited c 8% annual staff turnover rate) that allows its employees to take on broader responsibilities and offers extensive training (including programmes offered by its in-house ProCredit Academy located in Germany).

Another cost item that is unlikely to decline is marketing expenses, given PCB's continued focus on growing its deposit base (marketing expenses increased by 64% to c €7.0m in FY22). For example, the company highlighted the recent fierce competition for deposits in Kosovo and Serbia. PCB is also likely to continue making meaningful investments in its IT infrastructure (with related expenses up by 10% y-o-y to €20.5m in FY22). Consequently, we assume PCB's CIR will be c 63% in FY23 (accounting for some further one-off expenses) and 59% in FY27 (see Exhibit 15), which is somewhat more conservative than management's target.

Exhibit 15: PCB's historical and forecast CIR

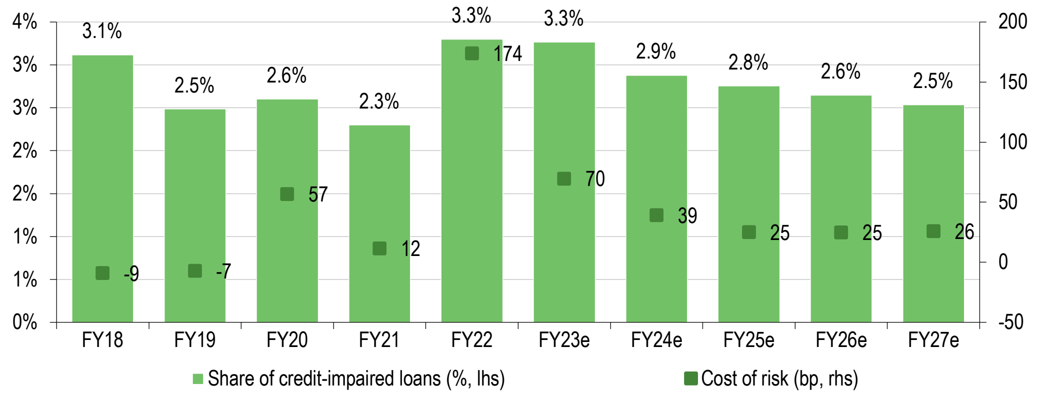


Source: ProCredit data, Edison Investment Research

Catalyst #4: Credit quality under control

PCB's mid-term target ROE assumes an average cost of risk of 25–30bp over the cycle, which compares to the group cost of risk of 33bp in FY22 excluding Ukraine and an average for FY17–22 of 17bp (again excluding Ukraine in FY22); see Exhibit 16.

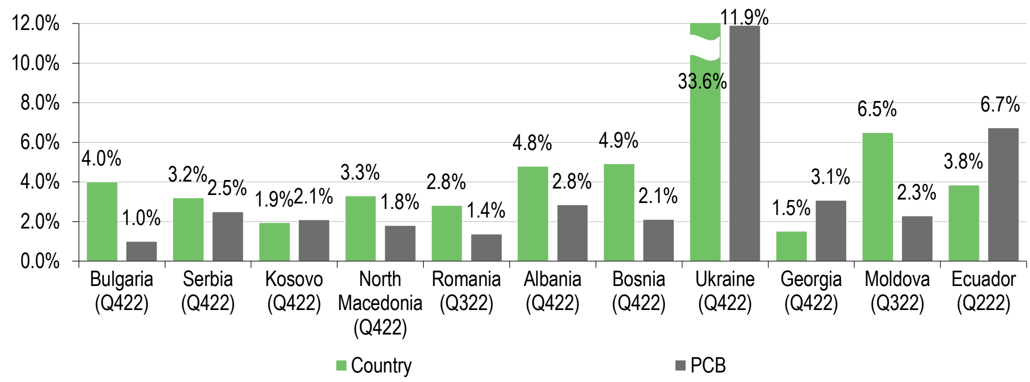
Exhibit 16: PCB's historical and forecast cost of risk



Source: ProCredit data, Edison Investment Research

While the mid-term cost of risk assumption of the management may seem slightly conservative versus the historical average, we note that previous years include a higher level of recoveries of written-off loans from portfolios of microloans disbursed earlier, which are no longer provided by PCB. That said, we consider the 25–30bp target as achievable given PCB's prudent approach to risk management based on building close, long-term business relationships with carefully selected SME borrowers, a holistic approach to client assessment without rigid scoring or automated lending, and its highly qualified credit risk staff. This is reflected in the relatively low share of credit-impaired loans for PCB versus most of its SEE/EE countries of operation. PCB's credit quality should also be assisted by the growing share of green loans, which historically exhibited a lower share of credit-impaired loans (2.4% in FY22, or 1.4% excluding Ukraine).

Exhibit 17: Share of credit-impaired loans – PCB versus local markets



Source: ProCredit data, IMF Financial Soundness Indicators. Note: Figures as at the quarter indicated in brackets on the X axis.

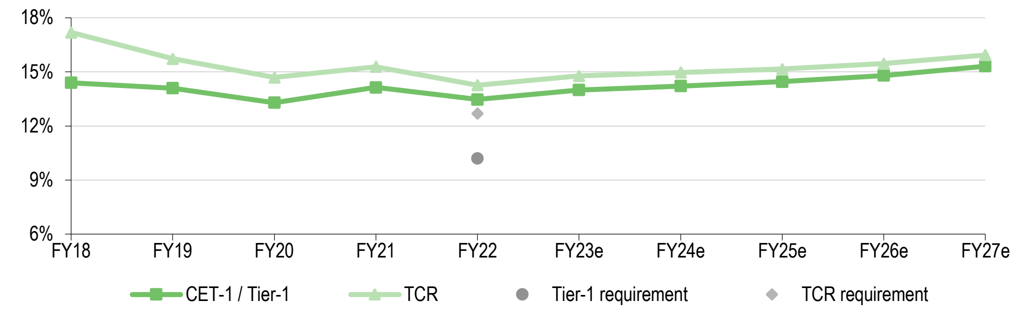
For FY23, PCB's management assumes a higher cost of risk level of up to 70bp, of which around half may come from Ukraine. The expected cost of risk in Ukraine is significantly lower than the 1,295bp in FY22, as ProCredit Bank Ukraine already has a high level of provisioning across its portfolio, with 16% of the total local loan book and 130% of the default portfolio covered (the share of credit-impaired loans in Ukraine at end-2022 was 11.9%). Moreover, while PCB released €16.4m of its COVID-19 provisions, it booked €39.6m of management overlays in FY22 (of which €28.9m was outside of Ukraine) to reflect the higher macroeconomic uncertainty.

Catalyst #5: Improved RWA density

PCB also sees potential for reducing the group's risk-weighted assets (RWA) to total assets, which stood at 69% at end-2022, above the 44% and 47% for Erste Group and Raiffeisen Bank International respectively. We understand that the higher ratio may be due to, among others: (1) a higher risk weight of mortgages on commercial versus residential real estate; (2) the higher risk weight of corporate versus retail loans; and (3) the lack of European Banking Authority (EBA) equivalence acknowledgement for some of PCB's countries of operation (which means that most of PCB's liquid assets have a 100% risk weighting).

PCB has several initiatives that are ongoing or planned, which it expects should reduce RWA by c €0.3–0.4bn, with PCB's mid-term RWA density target 60%. These include: (1) attribution of the infrastructure factor to selected renewable energy projects; (2) attribution of hard collateral to the RWA calculation according to the capital requirements regulation standardised approach for its Bulgarian portfolio; (3) widening the Multilateral Investment Guarantee Agency agreement, which allows PCB to reduce the RWA weighting of cash with central banks in countries without an EBA equivalence acknowledgement; and (4) portfolio securitisation. We also note that PCB's focus on SMEs rather than larger corporates assists its RWA due to the SME Supporting Factor introduced by the EBA. An improvement in RWA density would also support PCB's capital ratios. At end-2022, its CET-1 ratio (fully loaded) was 13.5%, with the total capital ratio at 14.3% (see Exhibit 18).

Exhibit 18: PCB's historical and forecast CET-1 and total capital ratio



Source: ProCredit data, Edison Investment Research

Catalyst #6: Stabilisation in Ukraine

Russia's invasion of Ukraine resulted in heavy allowances for credit losses in FY22 (€86.7m vs €0.3m in FY21) and ProCredit Bank Ukraine's decision to limit its new lending. Together with the 25% devaluation of the Ukrainian hryvnia (ie the downward adjustment of the rate at which it is pegged to the US dollar) in July 2022, this resulted in a €174m reduction in the local loan book and a decline in PCB's total loan book to 9% from 13% at end-2021.

Ukraine used to be the strongest earnings contributor for PCB, with an FY21 net profit of €23.7m before group items (versus PCB's net profit at a group level of €79.6m) translating into an ROE of 19.9%, well above the group average. The Ukrainian situation is difficult to predict and therefore PCB's management has designed three scenarios of prospective developments at the local bank. In its base case scenario, PCB assumes no bottom-line contribution in FY23 (with elevated cost of risk and operating expenses offsetting operating income). From FY24, PCB's management assumes under this scenario a net income contribution of upper single-digit to low double-digit million euros per annum. We discuss the other two scenarios in the sensitivities section below.

Valuation

We continue to value PCB using an implied P/BV based on a blend of our assessment of the bank's sustainable RoTE and cost of equity derived from a CAPM, and the regression line implied by the ROE and P/BV relationships at which PCB's peers currently trade.

In our CAPM, we have used country-level market risk premiums (as provided by Aswath Damodaran) weighted by PCB's gross loan book split by country at end-2022, arriving at an equity risk premium of 13.1% (previously 10.2%). We have used a risk-free rate of 2.51%, in line with the current euro area yield curve for a 10-year maturity. We have also applied a beta of 0.80x (in line with the average beta for banks in emerging markets as provided by Aswath Damodaran), which is a reduction from the 1.0x we used previously. We have retained our long-term growth rate assumption of 2.0%. Although we consider PCB's ROE target achievable and we have reflected the improving profitability outlook in our forecasts, we have conservatively retained at this stage our sustainable RoTE assumption of 10%. Our new assumptions imply a P/BV multiple for PCB of 0.72x (see Exhibit 19), versus 0.77x in our previous valuation.

A regression line based on FY23e P/BV and ROE indicators for PCB's peers implies a P/BV multiple (for PCB's sustainable RoTE of 10%) of 0.71x (see Exhibit 22). As a result, we have assumed a fair value multiple of 0.72x, which is the average of the multiple derived from the CAPM and the regression analysis. This implies a fair value per PCB share of €10.36 (slightly down from €10.80 in our November 2022 update (and implying 68% potential upside to the current price of €6.18). Here we acknowledge that the peer group is quite scattered across the P/BV-ROE map, making the regression line less reliable. We believe this may be due to a number of non-financial factors, such as political risk perceived by investors.

Assuming a sustainable RoTE of 12% (in line with management's mid-term target) would yield a fair value per PCB share of €12.08.

Exhibit 19: PCB's P/BV-ROE valuation

€'000s unless otherwise stated	FY22	FY23e	FY24e	FY25e	FY26e	FY27e
Shareholder's equity	869,435	942,197	1,016,121	1,099,655	1,190,960	**1,289,875**
Intangibles	17,993	17,993	17,993	17,993	17,993	17,993
Tangible equity	**851,442**	**924,204**	**998,128**	**1,081,662**	**1,172,967**	1,271,882
Net attributable profit	16,497	75,046	98,939	116,514	130,143	**142,296**
RoTE	***2.0%***	***8.5%***	***10.3%***	***11.2%***	***11.5%***	***11.6%***
Tangible equity per share (€)	**14.5**	**15.7**	**16.9**	**18.4**	**19.9**	**21.6**
Tangible equity per share (FY23e, €)	**15.7**					
Sustainable RoTE	10.0%					
Growth rate	2.0%					
Cost of equity	13.0%					
Fair value multiple – CAPM model	0.73x					
Fair value multiple – regression multiple	0.71x					
Fair value multiple – simple average	**0.72x**					
Fair value per share (end-2023, €)	11.26					
Discount factor	*0.92*					
Fair value per share (€)	**10.36**					
Current share price (€)	6.18					
Potential upside/downside	*68%*					

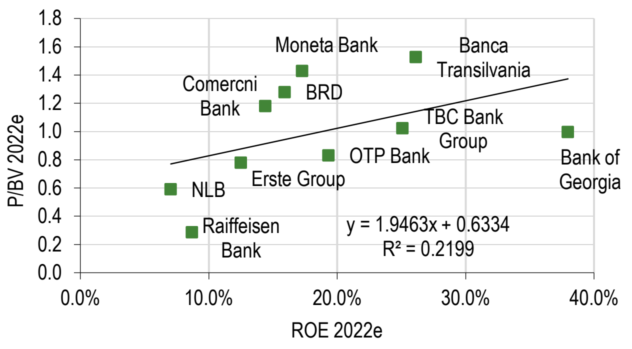
Source: ProCredit, Edison Investment Research

Exhibit 20: PCB's valuation sensitivity analysis (€/share)

		Sustainable RoTE						
		7.0%	**8.0%**	**9.0%**	**10.0%**	**11.0%**	**12.0%**	**13.0%**
Cost of equity	11.5%	8.30	9.27	10.23	11.19	12.16	13.12	14.09
	12.0%	8.11	9.04	9.96	10.89	11.81	12.74	13.67
	12.5%	7.94	8.83	9.72	10.61	11.50	12.39	13.28
	13.0%	7.78	8.64	9.50	**10.36**	11.22	12.08	12.94
	13.5%	7.64	8.47	9.30	10.13	10.96	11.79	12.62
	14.0%	7.51	8.31	9.12	9.92	10.72	11.53	12.33
	14.5%	7.39	8.17	8.95	9.73	10.51	11.29	12.07

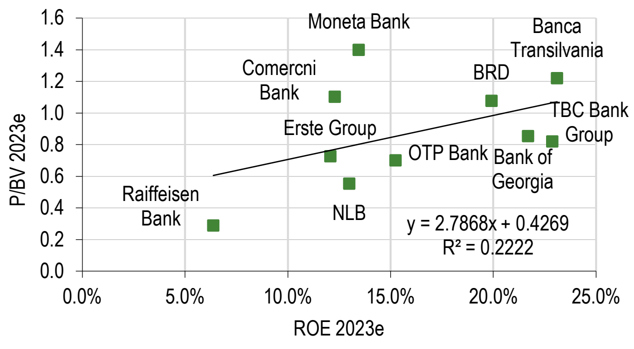
Source: Edison Investment Research

Exhibit 21: P/BV versus ROE – PCB's peers (2022)



Source: Refinitiv as at 27 April 2023. Note: 2022 figures are estimates for some of the companies. Raiffeisen Bank International figure is excluding Russia, Belarus and Bulgaria.

Exhibit 22: P/BV versus ROE – PCB's peers (2023e)



Source: Refinitiv consensus at 27 April 2023

Sensitivities

War in Ukraine

As developments in Ukraine remain difficult to foresee, PCB's management has presented an upside and a worst-case ('write-off') scenario. The latter assumes a one-time write-off of the remaining equity of ProCredit Bank Ukraine (€56.7m at end-2022) and group funding (€20m as at January 2023). This would have a significant impact on PCB's financial results in the year of the write-off, but would have a limited impact on its CET-1 ratio given the concurrent deconsolidation of local RWA (management expects the CET-1 ratio to remain stable at c 14.0% under this scenario). We estimate that this would result in a decline in our forecast PCB tangible equity as at end-2023 from c €924m to €778m (or from €15.7 to €13.2/share) and a fair value per share of €9.08, according to our estimates (still leaving 47% upside potential). This assumes the write-down of €56.7m of the local bank's equity, €20m of group funding and €70m of the maximum incremental funding allowed under PCB's agreement with its bondholders (which was not provided as at end-2022).

In our outlook note in July 2022, we highlighted that a material default event by ProCredit Bank Ukraine could lead to special termination rights in funding agreements at the PCB group level, which could result in additional liquidity risk for the group. While PCB considers the default risk of ProCredit Bank Ukraine as low at present, it has taken measures to mitigate the above-mentioned liquidity risk by amending the above-mentioned cross-default clauses to exclude ProCredit Bank Ukraine until 2024 in exchange for an annual fee of 0.5%. Of the approached creditors (which represented a nominal debt volume of €289.5m), those accounting for €221m agreed to this change.

We also acknowledge the risk of the war spilling over to neighbouring countries, in particular Moldova (3% of PCB's loan book at end-2022), which experienced political unrest that may have been inspired by Russia.

PCB's best-case scenario for Ukraine, which reflects the participation in the post-war reconstruction of the country (which could translate into double-digit loan growth pa), suggests medium-term ROE upside potential of 1.0–1.5pp pa.

Other sensitivities

Macroeconomic risk remains higher in PCB's countries of operation compared to Western Europe and Central and Eastern European (CEE) countries given the earlier stage of economic development and several challenges or risks these economies face (see our initiation note for details). Moreover, the region may be affected by a possible recession in Europe and we estimate that every 100bp deterioration in PCB's sustainable RoTE due to the long-lasting economic effects of the above would reduce our valuation by c €0.87 per share. Having said that, we note that growth in PCB's loan book proved resilient during a tougher economic environment, as illustrated by the 9.5% y-o-y growth at group level in 2020 despite COVID-19. It is also worth noting that while PCB released €16.4m of its macro provisions from the pandemic, it has booked €39.6m new management overlays to account for the current macroeconomic uncertainty, which constitutes a certain buffer in terms of loss provisions. Nevertheless, we have assumed above-average loss provisions in FY23 to reflect some deterioration in the credit quality of PCB's portfolio, also outside of Ukraine.

Foreign exchange risk: PCB is exposed to fx rate volatility due to its international operations. At group level, currency risk primarily arises from the changing value of the parent company's equity investments in regional banks, which are denominated in the respective domestic currencies and accounted for on an equity basis. This is directly reflected in PCB's equity in the changes to its translation reserve. However, the impact on PCB's CET-1 capital is normally largely offset by a corresponding downward fx impact on its RWA. It aims to reduce credit risk for clients and the group's banks by typically disbursing foreign currency loans only to customers that generate revenues in this currency. Finally, depreciation of domestic currencies could lead to a reduction in regulatory capital ratios at local banks, but PCB mitigates this risk by matching the foreign currency exposures of its assets and liabilities. Its use of hedging instruments is therefore limited. Some countries where PCB has a presence have pegged their domestic currencies to the euro, which inherently reduces their volatility versus the euro (the group's reporting currency); see our initiation note for details. Finally, we note that the official exchange rate of the Ukrainian hryvnia has been fixed as part of the martial law introduced in the Ukrainian banking system in February 2022, though it was adjusted downwards in July 2022.

Weather anomalies and natural disasters pose a risk for PCB's significant exposure to agriculture loans (18% at end-2022).

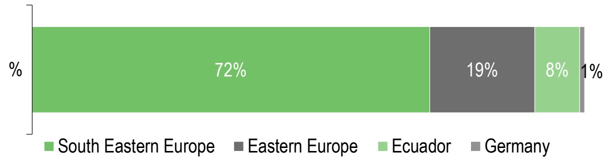
Fintech competition: a number of innovative companies (both balance sheet lenders and operators of digital marketplaces) seek to address the SME funding gap in Europe. These constitute potential new competition for PCB, given that they target a similar segment. Nevertheless, we believe that PCB's Hausbank approach, coupled with strong experience in the markets in which it operates, represents a significant competitive advantage.

Exhibit 23: Financial summary

Year ending 31 December, €000s	2018	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Income statement										
Net interest income	186,235	194,533	201,561	222,021	264,634	295,492	303,294	321,018	345,580	370,097
Net fee and commission income	52,172	51,972	47,380	50,855	54,731	57,914	61,825	65,801	70,067	74,641
Operating income	240,678	249,275	252,114	281,881	339,848	361,222	376,920	399,809	430,131	460,673
Operating expenses	167,866	175,737	171,430	180,859	217,428	228,910	234,872	245,082	258,214	272,060
Loss allowances	(4,714)	(3,327)	28,600	6,490	104,573	42,990	25,214	17,368	18,527	20,978
PBT	**77,526**	**76,865**	**52,084**	**94,532**	**17,847**	**89,322**	**116,835**	**137,359**	**153,390**	**167,635**
Net profit after tax	**54,477**	**54,304**	**41,395**	**79,641**	**16,497**	**75,046**	**98,939**	**116,514**	**130,143**	**142,296**
Reported EPS (€)	**0.90**	**0.89**	**0.70**	**1.35**	**0.28**	**1.27**	**1.68**	**1.98**	**2.21**	**2.42**
DPS (€)	0.30	0.00	0.53	0.00	0.00	0.42	0.56	0.66	0.74	0.81
Balance sheet										
Cash and balances at central banks	963,714	1,081,723	1,405,349	1,545,523	1,939,681	2,143,069	2,368,665	2,523,821	2,653,067	2,636,227
Loans and advances to banks	211,592	320,737	236,519	252,649	280,453	280,453	280,453	280,453	280,453	280,453
Investment securities	297,308	378,281	336,476	410,400	480,168	480,168	480,168	480,168	480,168	480,168
Loans and advances to customers	4,267,829	4,690,961	5,131,582	5,792,966	5,892,796	6,030,983	6,466,545	7,002,243	7,580,940	8,207,786
Property, plant and equipment and investment properties	130,153	138,407	140,744	137,536	133,703	133,703	133,703	133,703	133,703	133,703
Intangible assets	22,191	20,345	19,316	18,411	17,993	17,993	17,993	17,993	17,993	17,993
Other assets	73,396	67,106	59,315	58,416	81,330	69,944	81,330	69,944	81,330	69,944
Total assets	**5,966,184**	**6,697,560**	**7,329,301**	**8,215,901**	**8,826,124**	**9,156,314**	**9,828,857**	**10,508,326**	**11,227,654**	**11,826,274**
Liabilities to banks	1,014,182	1,079,271	1,235,763	1,313,666	1,318,647	949,426	873,472	786,125	746,818	522,773
Liabilities to customers	3,825,938	4,333,436	4,898,897	5,542,251	6,289,511	6,916,160	7,590,734	8,274,015	8,941,345	9,665,096
Debt securities	206,212	343,727	266,858	353,221	191,988	191,988	191,988	191,988	191,988	191,988
Subordinated debt	143,140	87,198	84,974	87,390	93,597	93,597	93,597	93,597	93,597	93,597
Other liabilities	33,076	50,436	63,080	63,059	62,946	62,946	62,946	62,946	62,946	62,946
Total liabilities	**5,222,549**	**5,894,068**	**6,549,573**	**7,359,587**	**7,956,689**	**8,214,116**	**8,812,737**	**9,408,671**	**10,036,694**	**10,536,400**
Total shareholders' equity	**743,634**	**803,492**	**779,728**	**856,314**	**869,435**	**942,197**	**1,016,121**	**1,099,655**	**1,190,960**	**1,289,875**
BVPS	12.5	13.5	13.2	14.5	14.8	16.0	17.3	18.7	20.2	21.9
TNAV per share	12.1	13.1	12.9	14.2	14.5	15.7	16.9	18.4	19.9	21.6
Ratios										
NIM	3.30%	3.10%	2.90%	2.90%	3.11%	3.29%	3.20%	3.16%	3.18%	3.21%
Costs/Income	69.7%	70.5%	68.0%	64.2%	64.0%	63.4%	62.3%	61.3%	60.0%	59.1%
ROE	7.6%	6.9%	5.3%	9.7%	1.9%	8.3%	10.1%	11.0%	11.4%	11.5%
CET1 Ratio	14.4%	14.1%	13.3%	14.1%	13.5%	14.0%	14.2%	14.5%	14.8%	15.3%
Tier 1 ratio	14.4%	14.1%	13.3%	14.1%	13.5%	14.0%	14.2%	14.5%	14.8%	15.3%
Capital adequacy ratio	17.2%	15.7%	14.7%	15.3%	14.3%	14.8%	15.0%	15.2%	15.5%	15.9%
Payout ratio (%)	33.3%	0.0%*	33.3%*	0.0%	0.0%	33.3%	33.3%	33.3%	33.3%	33.3%
Customer loans/total assets	73.6%	71.6%	71.7%	72.1%	69.1%	68.1%	67.6%	68.4%	69.2%	71.0%
Deposits/loans	87.1%	90.3%	93.2%	93.5%	103.1%	110.9%	114.2%	115.1%	115.1%	115.1%

Source: Company data, Edison Investment Research. Note: *In 2021, PCB distributed 1/3 of the accumulated profits from 2019 and 2020.

EDISON

Contact details	Loan portfolio by geography
Rohmerplatz 33–37 60486 Frankfurt Germany +49 69 951 437 0 procredit-holding.com	

Management team	
Chairman: Hubert Spechtenhauser	**Board member: Christian Dagrosa**
Hubert Spechtenhauser joined in March 2022 and became the first chairman of the management board. He has held various senior managerial positions at Commerzbank Group, Landesbank Hessen-Thüringen (Helaba) Group and UniCredit Group. At ProCredit, he is responsible for legal aspects, group communication and internal audit.	Christian Dagrosa joined ProCredit Holding in 2017 and between 2019 and 2022 was an authorised representative of the company ('prokurist') and manager responsible for investor relations, as well as reporting and controlling. He is currently board member responsible for accounting and taxes, supervisory reporting and capital planning, group funding and treasury, controlling, reporting and data management, investor relations, as well as administration and translation.
Board member: Dr Gian Marco Felice	**Board member: Sandrine Massiani**
Dr Gian Marco Felice joined the management board in June 2020. He has held various managerial positions within the group since 2001 and is now responsible for business support, environmental management and impact reporting, as well as IT.	Sandrine Massiani joined PCB in 2007 and initially worked as regional coordinator in Africa. She became coordinator of the group's human resources in 2011, and manager of human resources and IT in 2015. She was appointed to the management board in 2017 and is currently overseeing credit, financial and operational risk management and risk control, fraud prevention, compliance and AML, as well as human resources.

Principal shareholders	(%)
Zeitinger Invest	18.3
KfW	13.2
DOEN Participaties	12.5
TIAA	8.6
International Finance Corporation	5.1
Free float	42.3

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