EDISON

ProCredit Holding

Q223 results

On track to meet FY23 ROE guidance of 8–10%

Banks

ProCredit Holding (PCB) produced another strong set of quarterly results with a net income of €34.6m in Q223, implying an annualised return on equity (ROE) of 15.0% (and 14.2% in H123). Importantly, most of PCB's regional banks contributed to the solid profitability, including ProCredit Bank Ukraine, which posted a 39.7% ROE in H123. This makes the company well positioned to meet management's FY23 ROE guidance of 8–10%, despite headwinds in the Ukrainian agricultural sector, further deposit repricing and personnel cost inflation. Still, PCB's shares currently trade at just 0.46x our FY23e book value per share.

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV (x)	P/E* (x)	ROE (%)
12/21	222.0	1.35	0.00	0.52	5.6	9.7
12/22	264.6	0.28	0.00	0.51	27.0	1.9
12/23e	304.0	1.55	0.52	0.46	4.9	10.0
12/24e	312.5	1.71	0.57	0.43	4.4	10.1

Note: *EPS as reported by the company

Still benefiting from a high net interest margin

PCB's net interest margin (NIM) remained high at 3.6% in Q223 (Q222: 3.1%), supported by base rates that further increased or remained at levels visibly above last year in most of its countries of operations. PCB's NIM also benefited from an improved funding mix, with customer deposits up 2.7% in H123 and the deposit-to-loan ratio up to 104.9% at end-June 2023 versus 103.1% at end-2022. Despite a focus on margin optimisation and targeted loan reduction in some countries, PCB's loan book increased by 0.8% in H123 (Q223: 1.6%). Together with a 9.1% y-o-y growth in net fee and commission income, this led to an 18.8% y-o-y rise in operating income (above the growth in operating expenses), resulting in a cost income ratio of 59.7% in Q223 (Q222: 61.0%). PCB's cost of risk was minimal at 2bp in H123.

Management reiterated its FY23 guidance

Management still guides to an ROE of 8–10% for FY23, which at first glance may seem conservative given the 14.2% ROE in H123. However, PCB may have to book additional loss allowances due to Russia's recent withdrawal from the grain deal and its air strikes on Ukrainian port and grain storage infrastructure. Moreover, PCB's deposit base is yet to fully reflect the higher base rates, and the group sees pressure on wages, which will lead to higher personnel expenses in H223. That said, even after factoring in the above headwinds (including FY23 cost of risk at the upper end of its guidance, ie 45bp), we expect an FY23 ROE of c 10%.

Valuation: Remaining underappreciated

We have raised our fair value estimate in our base scenario (which assumes a sustainable return on tangible equity, RoTE, of 10%) to €11.40/share (from €10.30 previously) due to updates to the country risk premiums and regression P/BV multiple used in our valuation model, as well as higher FY23 forecasts. Assuming an RoTE in line with PCB's mid-term guidance (12%), PCB would be valued at €13.40/share. Finally, in a worst-case scenario of full write-off of the local bank in Ukraine, we would value PCB at €10.00/share.

23 August 2023

Price	**€7.56**
Market cap	**€445m**
Total assets (€bn) at end-June 2023	9.0
Shares in issue	58.9m
Free float	38.7%
Code	PCZ
Primary exchange	Frankfurt Prime Standard
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	4.7	25.2	119.1
Rel (local)	7.9	29.3	84.6
52-week high/low		€7.88	€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

Equity Forum Fall Conference 2023	4–5 September 2023
Q323 results	14 November 2023
Deutsches Eigenkapitalforum	27–29 November 2023

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Edison profile page

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Q223 annualised ROE at 15.0%

PCB reported a strong €34.6m net income in Q223 (vs €9.4m in Q222, see Exhibit 1), translating into a 15.0% annualised ROE in Q223 and bringing the H123 annualised figure to 14.2%. This is well above PCB's current FY23 guidance of 8–10% (raised in May 2023 from 6–8% communicated earlier this year) and ahead of the medium-term guidance of around 12%. Encouragingly, most of the regional banks contributed to the healthy profitability, with all Southeastern European (SEE) banks reporting an annualised ROE of 11–13% (except for Kosovo at 23% and Albania at 7%), while banks in Ukraine, Georgia and Moldova reported ROEs of c 40%, 19% and 20%, respectively. Ecuador was again an outlier with a slight loss in H123 (see more details on Ecuador below).

Exhibit 1: Q223 and H123 results highlights

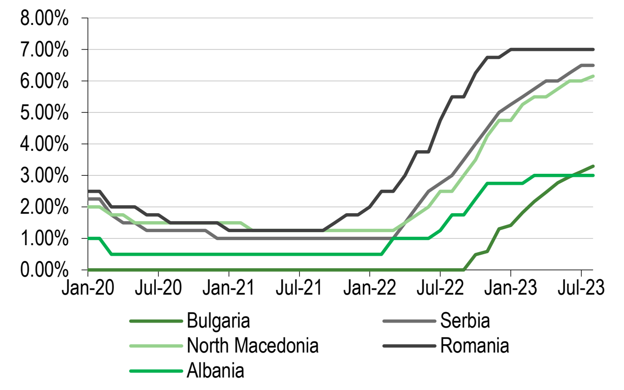
€m, unless otherwise stated	Q223	Q222	y-o-y change	H123	H122	y-o-y change
Net interest income	80.2	64.7	24.1%	155.7	124.8	24.7%
Net interest margin (annualised)	3.6%	3.1%	47bp	3.5%	3.0%	49bp
Expenses for loss allowances	-1.3	21.7	NM	0.5	57.3	NM
Cost of risk (annualised, bp)	-9	141	-150bp	2	188	-186bp
Net fee and commission income	14.9	13.7	9.1%	28.9	26.3	9.9%
Pre-tax profit	40.8	10.4	292%	76.7	6.6	NM
Net income	**34.6**	**9.4**	**267%**	**64.1**	**7.7**	**NM**
ROE	15.0%	4.4%	1066bp	14.2%	1.8%	NM
Cost income ratio	59.7%	61.0%	-129bp	59.7%	60.1%	-41bp
CET-1 ratio	14.2%	13.7%	0.4pp	14.2%	13.7%	0.4pp
Deposit-to-loan ratio	104.9%	91.2%	13.7pp	104.9%	91.2%	13.7pp
Gross loan portfolio growth (q-o-q)	1.6%	4.4%	-2.5pp	3.9%	6.2%	-2.3pp
Customer deposits growth (q-o-q)	2.1%	4.1%	-2pp	2.7%	3.6%	-0.9pp

Source: ProCredit Holding

NIM still strong, CIR below 60%

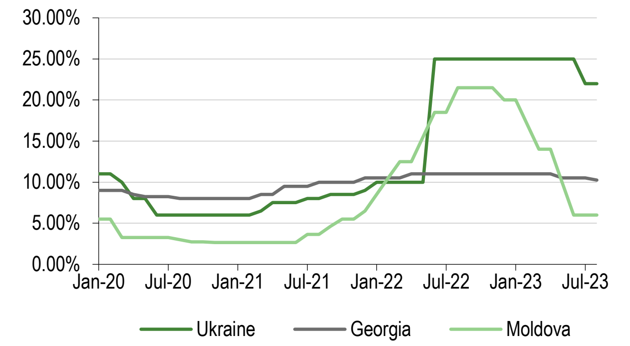
The solid set of results was assisted by a continuously high NIM (3.6% in Q223 vs 3.1% in Q222) amid interest rate normalisation across most countries of PCB's operations (despite some rate cuts in the Eastern European countries), see Exhibits 2 and 3. It is worth noting that almost all local PCB banks contributed to the sequential NIM expansion. The stronger interest income was driven by customer loans, but also by central bank balances and investment securities.

Exhibit 2: Central bank policy rates in the SEE region



Source: Local central banks

Exhibit 3: Central bank policy rates in the EE region

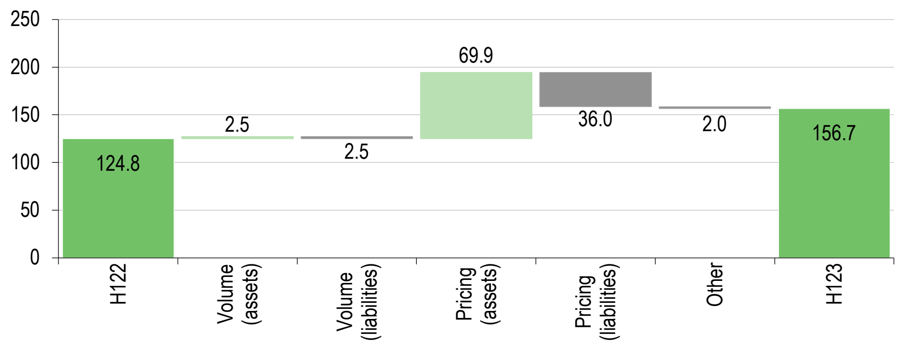


Source: Local central banks

NIM was also assisted by the improving deposit-to-loan ratio (104.9% at end-June 2023 vs 91.2% at end-June 2022 and 103.1% at end-2022), on the back of a 2.7% increase in customer deposits, as well as the fact that customer deposits are yet to fully capture the base rate hikes (see Exhibit 4). Together with a slight sequential increase in the loan book (up 0.8% during H123, down c 2.2%

y-o-y due to targeted loan book reduction and local currency devaluation in July 2022 in Ukraine), this resulted in a 24.1% y-o-y rise in net interest income to €80.2m in Q223. In Q223 alone, the loan book rose by 1.6% as PCB experienced gradually improving sentiment among SMEs to pursue new investments.

Exhibit 4: PCB's net interest income H123 versus H122 (€m)



Source: ProCredit Holding

PCB's earnings were further driven by 9.1% y-o-y growth in net fee and commission income to €14.9m (assisted by a focus on adding private individual and non-loan business clients), translating into an 18.8% y-o-y improvement in operating income in Q223 to €98.0m, outpacing the 16.3% y-o-y growth in operating expenses to €58.6m. This allowed PCB to keep the cost income ratio (CIR) under control at 59.7% in both Q223 (vs 61.0% in Q222) and H123, ahead of the 62–64% management guidance for FY23. After adjusting for extraordinary items, PCB's CIR was 58.3% in H123, 1.5pp below H122 and close to PCB's medium-term target of c 57%.

H123 cost of risk at a low level

PCB booked a €1.3m net release of loan loss provisions in Q223 (or 9bp of the gross loan book), resulting in an H123 cost of risk of 2bp. The H123 net provisioning was driven by €6.7m in recoveries of written off loans and a €6.2m positive impact from model parameter updates. This has more than offset new loss allowances from stage transfers (€11.0m) and some minor incremental management overlays (€1.5m). Total management overlays for macroeconomic risks as at end-June 2023 reflected in PCB's loan loss provisions stood at €41.0m (of which c €11.1m was attributable to ProCredit Bank Ukraine). The share of credit-impaired loans in PCB's loan book outside of Ukraine stood at a moderate 2.3% at end-June 2023 (12.4% in Ukraine, with a 130% coverage ratio of the default portfolio).

Capital base remains sound

PCB's CET1 ratio stood at 14.2% at end-June 2023 versus 13.5% at end-2022 and the current regulatory requirement of 9.2%, assisted by the full attribution of FY22 profit and continued improvements to risk-weighted asset (RWA) efficiency (see our last outlook note for details). Two-thirds of the H123 result will be attributed to the CET1 capital in Q323, which on a pro-forma basis translates into a CET1 ratio of 14.8%.

PCB's Multilateral Investment Guarantee Agency (MIGA) collaboration was broadened to include an additional agreement for Ukraine (signed in June 2023), with the latter resulting in a €35m RWA release, bringing the combined MIGA collaboration effect to €140m (or 25bp in CET1 ratio improvement year-to-date). Moreover, PCB embarked on a securitisation project with the European Investment Fund in Bulgaria, with a positive RWA impact of €180m (or a 32bp contribution to the year-to-date CET1 ratio improvement). PCB's total capital ratio reached 15.3% at end-June 2023 versus 14.3% at end-2022 and the current regulatory requirement of 14.2%.

Environmental and governance milestones achieved

PCB achieved an important milestone on its carbon neutrality agenda (see the key takeaways from PCB's Impact Report 2022 in our previous update note for details) by commissioning its 3MW photovoltaic park in Kosovo, which will compensate for 85–90% of its stage 1 and 2 emissions. We also note that PCB's 2023 AGM resolved with a large majority to change its legal form to a stock corporation (with conversion expected to be completed in Q323).

PCB adjusting to the uncertainty caused by political and social unrest in Ecuador

Ecuador successfully completed the Sixth Review under the Extended Arrangement under Extended Fund Facility of the International Monetary Fund (IMF) in December 2022 and the IMF expects the economy to grow by 2.9% in 2023 with consumer price inflation at a moderate 2.5%. However, the country has been experiencing a challenging internal situation marked by political instability and criminal gang violence, culminating recently with the assassination of a presidential candidate.

The associated uncertainty is likely to weigh on SMEs' willingness to commit to new investments and in turn on demand for PCB's loans. This applies especially to larger SMEs and therefore PCB shifted its focus to small SMEs (with an individual loan size of c €100k vs PCB's general focus on €50k to €1.5m), also because the lending rate caps imposed by the government are higher in this segment (PCB's NIM in Ecuador declined to 3.2% in H123 from 4.6% in H122). The share of credit-impaired loans at PCB's local bank stood at 6.6% at end-June 2023.

While PCB managed to grow its customer deposits in Ecuador by 12.8% y-o-y in Q223, these have remained broadly flat year-to-date (lagging behind other regional banks), which was partly due to local liquidity being moved to safer jurisdictions (the US in particular), a phenomenon typical in periods of rising US dollar interest rates. That said, as the local loan book declined slightly in H123, PCB's deposit-to-loan ratio improved slightly to 69.4% at end-June 2023, versus 68.9% at end-2022 (and 62.8% at end-June 2022), though below management ambitions in this respect. The local bank posted a slight €0.4m loss in H123.

Why has management not raised its FY23 guidance further by now?

We estimate that, following the strong H123 results (14.2% ROE), the management's current FY23 ROE guidance of 8–10% implies an H223 annualised ROE of c 2–6%, which at first glance looks conservative. However, there are several factors that may lead to lower profitability for PCB in the second half of the year:

- **War in Ukraine:** while the bulk of portfolio reclassification at ProCredit Bank Ukraine was completed as at end-June 2023, PCB's provisions are yet to reflect the impact of Russia's recent withdrawal from the grain deal and its air strikes on the Black Sea and Dnipro port and grain storage infrastructure across Ukraine. The share of agricultural loans in PCB's local loan book is substantial, ahead of group level of 18% at end-June 2023. That said, management highlighted that the upper end of the FY23 cost of risk guidance of 45bp covers an even more adverse scenario than what is currently unfolding in Ukraine. We note that ProCredit Bank Ukraine contributed €12.4m of net profit in H123 (above the pre-war H121 net profit of €10.7m). This represented a 39.7% annualised ROE, though boosted by the equity decline from c

€130.0m at end-2021 to €67.7m at end-June 2023. Management cautiously assumes in its current FY23 guidance 'zero' bottom-line group contribution from ProCredit Bank Ukraine.

- **Contracting NIM:** PCB's management expects a continued repricing of deposits, as most of the growth it has seen recently has come (unsurprisingly) from term deposits rather than sight deposits. This should result in a reduced NIM compared to H123.
- **Wage inflation:** salary reviews are now being carried out throughout the year rather than at a single point during the year. PCB's management highlighted that average wages went up by 9% y-o-y in H123 and it expects a further increase in Q323. The H123 rise was accompanied by a c 10% y-o-y headcount increase, as PCB continues to expand the teams across local banks (including in Ukraine).
- **Seasonal factors:** the fourth quarter of each year is often characterised by additional operating expenses (eg payments for untaken leave).

Forecast revisions

However, given the encouraging H123 results, we have raised our FY23 net income forecast by 7.6% to €91.2m, primarily on the back of higher net interest income assumptions, especially for assets other than customer loans. This implies an FY23 ROE of 10%, which is at the upper end of management's FY23 guidance (vs our previous forecast of 9.3%) and also translates into an FY23 CIR ratio of 63.8% (ie within management guidance of 62–64%). We have slightly reduced our longer-term ROE assumptions though, as we now cautiously do not assume that PCB's Ecuadorian bank will return to sustainable profitability in the medium term. Therefore, our FY27 ROE forecast is now 11.4% versus 11.5% previously and management's medium-term target of around 12%.

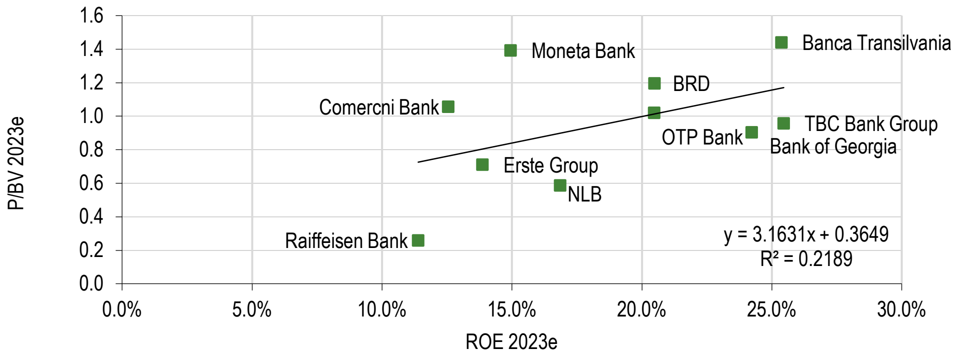
Exhibit 5: Forecast revisions

	2022	2023e				2024e			
€m, unless otherwise stated	**Actual**	**Old**	**New**	**Change**	**Growth y-o-y**	**Old**	**New**	**Change**	**Growth y-o-y**
Net interest income	264.6	296.5	304.0	*2.5%*	*14.9%*	305.6	312.5	*2.2%*	*2.8%*
Net interest margin (%, annualised)	3.1%	3.3%	3.4%	*0.1pp*	*0.2pp*	3.2%	3.2%	*0pp*	*-0.1pp*
Expenses for loss allowances	104.6	28.5	28.0	*-1.7%*	*-73.2%*	29.1	24.1	*-17.4%*	*-14.0%*
Cost of risk (annualised in bp)	174	46	45	*-1bp*	*-129bp*	45	37	*-8bp*	*-8bp*
Net fee and commission income	54.7	59.4	59.6	*0.3%*	*8.9%*	62.5	63.2	*1.1%*	*6.0%*
Operating expenses	217.4	237.2	241.7	*1.9%*	*11.2%*	242.7	248.4	*2.4%*	*2.8%*
Pre-tax profit	17.8	102.8	109.2	*6.3%*	*512.0%*	109.8	118.9	*8.2%*	*8.9%*
Net income	**16.5**	**84.7**	**91.2**	***7.6%***	***452.8%***	**92.5**	**101.0**	***9.1%***	***10.7%***
ROE	**1.9%**	**9.3%**	**10.0%**	***0.7pp***	***8pp***	**9.4%**	**10.1%**	***0.7pp***	***0.2pp***
CET1 ratio (%)	13.5%	14.4%	14.6%	*0.2pp*	*1.1pp*	14.2%	14.3%	*0pp*	*-0.4pp*
Total capital ratio (%)	14.3%	15.6%	15.8%	*0.2pp*	*1.5pp*	15.4%	15.4%	*0pp*	*-0.4pp*
CIR (%)	64.0%	64.4%	63.8%	*-0.6pp*	*-0.2pp*	63.6%	63.5%	*-0.1pp*	*-0.3pp*
Gross loan portfolio	6,103.2	6,258.6	6,250.3	*-0.1%*	*2.4%*	6,674.7	6,633.8	*-0.6%*	*6.1%*
Net loan portfolio	5,888.3	6,056.6	6,030.5	*-0.4%*	*2.4%*	6,491.4	6,433.6	*-0.9%*	*6.7%*
Customer deposits	6,289.5	6,910.2	6,777.9	*-1.9%*	*7.8%*	7,583.0	7,390.9	*-2.5%*	*9.0%*

Source: ProCredit Holding, Edison Investment Research

Our revised forecasts, together with new country risk premiums (based on updated data published by Aswath Damodaran in July) and updated FY23e P/BV-ROE peer analysis (see below) now imply a fair value in our base scenario (assuming a 10% sustainable ROE) of €11.40/share. Assuming an RoTE in line with management's mid-term guidance (12%), PCB would be valued at €13.40/share. Finally, in a worst-case scenario of the full write-off of the local bank in Ukraine, we would value PCB at €10.00/share.

Exhibit 6: P/BV versus ROE – PCB's peers (2023e)



Source: Refinitiv consensus at 23 August 2023

Exhibit 7: 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	304,004	312,455	320,733	345,830	370,534
Net fee and commission income	52,172	51,972	47,380	50,855	54,731	59,609	63,195	67,738	72,177	76,944
Operating income	240,678	249,275	252,114	281,881	339,848	378,896	391,365	405,499	436,692	467,932
Operating expenses	167,866	175,737	171,430	180,859	217,428	241,690	248,391	257,660	269,148	281,186
Loss allowances	(4,714)	(3,327)	28,600	6,490	104,573	27,975	24,066	17,750	17,936	20,023
PBT	**77,526**	**76,865**	**52,084**	**94,532**	**17,847**	**109,231**	**118,908**	**130,090**	**149,608**	**166,723**
Net profit after tax	**54,477**	**54,304**	**41,395**	**79,641**	**16,497**	**91,191**	**100,960**	**110,519**	**127,488**	**142,238**
Reported EPS (€)	**0.90**	**0.89**	**0.70**	**1.35**	**0.28**	**1.55**	**1.71**	**1.88**	**2.16**	**2.41**
DPS (€)	0.30	0.00	0.53	0.00	0.00	0.52	0.57	0.63	0.72	0.80
Balance sheet										
Cash and balances at Central Banks	963,714	1,081,723	1,405,349	1,545,523	1,939,681	2,278,533	2,534,082	2,783,457	2,992,523	2,788,761
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	6,030,516	6,433,593	6,942,131	7,489,844	8,012,527
Property, plant and equipment and investment properties	130,153	138,407	140,744	137,536	133,703	134,943	134,943	134,943	134,943	134,943
Intangible assets	22,191	20,345	19,316	18,411	17,993	19,236	19,236	19,236	19,236	19,236
Other assets	73,396	67,106	59,315	58,416	81,330	80,076	81,038	80,076	81,038	80,076
Total assets	**5,966,184**	**6,697,560**	**7,329,301**	**8,215,901**	**8,826,124**	**9,303,926**	**9,963,512**	**10,720,464**	**11,478,205**	**11,796,164**
Liabilities to banks	1,014,182	1,079,271	1,235,763	1,313,666	1,318,647	1,199,969	1,175,969	1,234,768	1,284,159	834,703
Liabilities to customers	3,825,938	4,333,436	4,898,897	5,542,251	6,289,511	6,777,901	7,390,925	8,012,212	8,629,914	9,297,587
Debt securities	206,212	343,727	266,858	353,221	191,988	181,296	181,296	181,296	181,296	181,296
Subordinated debt	143,140	87,198	84,974	87,390	93,597	113,660	113,660	113,660	113,660	113,660
Other liabilities	33,076	50,436	63,080	63,059	62,946	68,395	68,395	68,395	68,395	68,395
Total liabilities	**5,222,549**	**5,894,068**	**6,549,573**	**7,359,587**	**7,956,689**	**8,341,221**	**8,930,245**	**9,610,331**	**10,277,424**	**10,495,641**
Total shareholders' equity	**743,634**	**803,492**	**779,728**	**856,314**	**869,435**	**962,704**	**1,033,267**	**1,110,133**	**1,200,782**	**1,300,523**
BVPS	12.5	13.5	13.2	14.5	14.8	16.3	17.5	18.8	20.4	22.1
TNAV per share	12.1	13.1	12.9	14.2	14.5	16.0	17.2	18.5	20.1	21.8
Ratios										
NIM	3.30%	3.10%	2.90%	2.90%	3.11%	3.35%	3.24%	3.10%	3.12%	3.18%
Costs/Income	69.7%	70.5%	68.0%	64.2%	64.0%	63.8%	63.5%	63.5%	61.6%	60.1%
ROAE	7.6%	6.9%	5.3%	9.7%	1.9%	10.0%	10.1%	10.3%	11.0%	11.4%
CET-1 ratio	14.4%	14.1%	13.3%	14.1%	13.5%	14.6%	14.3%	14.3%	14.6%	15.5%
Tier 1 ratio	14.4%	14.1%	13.3%	14.1%	13.5%	14.6%	14.3%	14.3%	14.6%	15.5%
Capital adequacy ratio	17.2%	15.7%	14.7%	15.3%	14.3%	15.8%	15.4%	15.4%	15.6%	16.4%
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%	67.2%	66.6%	66.6%	66.9%	69.6%
Deposits/loans	87.1%	90.3%	93.2%	93.5%	103.1%	108.4%	111.4%	112.3%	112.4%	113.3%

Source: Company data, Edison Investment Research. Note: *In 2021, PCB distributed one-third of the accumulated profits from 2019 and 2020.

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