Statement from the Management of ProCredit Holding on implications of the COVID-19 pandemic

Frankfurt am Main, 27 April 2020

In light of the economic repercussions from various national and international measures to slow down the spread of the novel coronavirus, the European Central Bank as well as the Federal Financial Supervisory Authority of Germany (Bundesanstalt für Finanzdienstleistungen or BaFin) have released a recommendation to banks to withhold all dividend pay-outs and share buy-backs during the pandemic, at least until 1 October 2020. We have discussed this matter with the Supervisory Board of ProCredit Holding and, after due consideration of all relevant aspects, decided to postpone the shareholders' decision on dividend distribution, thus following the regulators' recommendation. In addition, for the first time our Annual General Meeting will take place as a virtual event without the physical presence of the shareholders or their proxies.

In these uncertain times, we consider prompt and transparent communication to be extremely important. The following provides a summary of where we see the group today as well as our view on the opportunities and risks for the year 2020 and beyond.

The COVID-19 pandemic and the comprehensive containment measures are having a profound impact on society and economies. The short-term macroeconomic projections are pessimistic. We believe that in these turbulent times it is important not to be distracted by the headlines. We will continue to focus on the reality of individual clients and individual markets, to take prompt and practical action in order to make a positive contribution for our clients and thus also for our banks. Certainly, we are aware of the important role our banks will take in supporting small and medium-sized enterprises. We can make a real difference for our clients and have a positive social impact. Looking forward, we are convinced that a robust SME sector will be central to prompt macroeconomic recovery in our markets post-pandemic. Looking back, the solid results of 2019 stand us in good stead for 2020.

2019 performance and strong impact positioning form a good basis for managing the demands of 2020

Our "Hausbank for SME" positioning further strengthened over 2019 with 10.3% growth in the loan portfolio and strong growth in deposit volumes from SME clients. About 30% of our growth came from our green loan portfolio, which now represents some 17% of our total loan portfolio. We saw particularly strong growth from renewable energy project finance, which is characterised by stable income streams. Longer-term investment loans account for 72% of our growth and 67% of our outstanding portfolio, underlining the special nature of our client relationships and the long-term view of our business model.

Over the years and in the course of our strategic shift to focus on SME lending, we have built a loan portfolio which now essentially comes from well-established business clients that meet our strict selection criteria for good management and sustainable, forward-looking business models. These businesses have typically already experienced “crises”, have certain reserves and have a fair capacity to respond and adjust even to severe macroeconomic turmoil. Our approach towards these clients has always been centred around the “Hausbank” concept – which relies on close client relationships managed by highly experienced staff.

This approach has helped us build a long track record of very good loan portfolio quality in the past. In the current situation, it will help us to work effectively with our clients and thus limit the level of arrears. We believe our long-term and individual client focused approach as well as prudent credit risk management are key comparative advantages for us, particularly with respect to the upcoming challenges. In the past, this has resulted in a continuously high loan portfolio quality, marked by default rates that are regularly well below the banking sectors in which we operate. In our markets of operation, we have observed a marked growth in aggressive consumer lending in recent years. We believe that these portfolios will now be particularly vulnerable, especially given emerging market governments’ limited capacity to buffer the impact of higher unemployment. We have never pushed consumer lending and have throughout the years maintained high loan and collateral standards, according to which the client’s repayment capacity is the primary criterion. Today, 93% of our portfolio consists of loans to SMEs and 6% housing loans to private individuals.

The expansion of our “Hausbank for SME” concept has been complemented by the execution of our “ProCredit Direct” strategy for our deposit business. Over 2019 our deposit base grew by 14.2%. We see it as an important breakthrough to have increased our deposit to loan ratio in a year when we also saw strong loan growth. Our digital banking approach means efficiency and scalability. In the current situation, it also means stability and safety, since it provides clients with a contactless mechanism for communicating with us and conducting their banking transactions without any restriction despite stay-at-home orders.

In 2019, we also expanded our relationships with international financial institutions. We successfully placed a pioneering green bond with IFC (International Finance Corporation – World Bank Group) to support the fast growth in our energy efficiency and renewable energy loans. We are one of the largest partners of the European Investment Fund’s InnovFin guarantee programme and are currently working to further intensify this partnership. These programmes, which today back approximately 12% of our total loan portfolio, bring valuable additional protection and capital relief to our group.

A solid capital structure is also now more important than ever. At the end of 2019 our CET 1 ratio stood at 14.1%. Since then our group has benefited from a reduction in SREP requirements of 50 basis points, and from a reduction of risk weighted assets of roughly EUR 120m coming from the EBA’s equivalence acknowledgement of Serbian banking regulation. Furthermore, we expect the introduction of CRR II (Capital Requirements Regulation) in 2021 and the extension of the SME factor to exposures above EUR 1.5m to have a reducing effect on RWA. The solidity of the group's capital position and its ability to absorb unexpected losses is best underlined by its very solid leverage ratio, which as of December 2019 stood at 10.8%.

In 2019, Fitch Ratings raised ProCredit Holding's viability rating from bb- to bb, while the BBB issuer default rating was affirmed. In the course of the past few weeks, rating actions were taken against many European banks, as economic projections became increasingly pessimistic. In this context, Fitch re-affirmed the ratings of ProCredit Holding along with the ratings of most ProCredit banks in April 2020, while maintaining the rating outlook as "stable".

Postponement of decision to distribute dividends

On 26 March 2020, in line with our dividend policy, we confidently expressed our intention to propose to shareholders that the company pay out one third of consolidated profits. We based this decision on a thorough assessment of our capital position and our confidence in our ability to manage the challenges of the current crisis. We believe that consistency towards our shareholders is as important as consistency towards our clients. Our dividend policy is in this respect a central commitment to our shareholders. At the same time, we must give due consideration to the regulators' recommendations towards the banking sector as a whole. The European Central Bank (ECB) and the German supervisory authorities strongly recommend not to disburse dividends before October 2020. The regulators have also made announcements concerning temporary relief measures to help banks provide as much support as possible to the economy. In this context, we chose to postpone the decision regarding the distribution of dividends in relation to the financial year 2019 until the fourth quarter of 2020.

Managing the impact of the COVID-19 pandemic: risks and opportunities

It is clear that the projections for global economic development in 2020 are very negative. Our countries of operation will be impacted: governments across Eastern and South Eastern Europe directly imposed stringent lockdown arrangements, which will last at least into May, to slow down the spread of the virus. For most of our countries a decline in GDP in 2020 is projected, followed by a marked recovery in 2021, assuming relaxation of control measures in the second half of 2020. Certainly, the banking sector will be at the forefront of providing support to the economy during and after the crisis.

ProCredit banks are well placed to play a significant and positive part in their respective countries. Our digital approach to all routine banking transactions has enabled us quickly to implement remote working models to protect the health and safety of clients and staff. We enjoy significant advantages from our very slim branch structure and the proven digital platform for most client-facing and back office routine transactions. Since 2013, we have closed hundreds of branches, reduced our staff by roughly 75% and virtually abolished over-the-counter and cash transactions, while continuously growing in our core segment of SME loans. Basically, all our clients are already fully on-boarded to use electronic channels for all their transactions. In contrast, we can observe that many other banks in our markets are still primarily branch-based and are facing significant challenges in reorganising branch operations. Since the business operations of our banks have not been seriously impacted by physical contact constraints, we have been able to focus directly on proactive client communication and acquisition.

Clearly, credit risk management will continue to be a focus of our activities in 2020. Generally our approach to credit risk management is built around close communication with our clients combined with effective portfolio monitoring and appropriate group-wide standards regarding credit risk assessment, client monitoring, loan restructuring and arrears management procedures. We do not have large portfolios to industry sectors that are strongly affected by the current situation. For example, hotels and travel account for only about 4% and transport and logistics about 5% of our total loan portfolio. We have insignificant exposure to automotive production/supply and to oil and gas production/supply. Overall, our portfolio is broadly diversified over countries, markets and industry sectors, with the single largest client exposure representing around 1.5% of the group's CET 1 capital. We believe that our exposure to the agricultural sector, which represents more than 20% of our portfolio, as well as our renewable energy portfolio, should be particularly robust in this economic downturn.

It is worth noting that in our countries of operation, national bank regulators have responded relatively quickly to the pandemic in order to manage the impact on households and businesses and the economy as a whole. Providing for debt moratoria is a common measure, which effectively allows debtors to delay debt service payments typically for three to nine months, when earnings are depressed. In March 2020, regulators clarified that moratoria in response to the COVID-19 pandemic do not have to be automatically classified as forbearance measures. Clearly, these measures serve an important purpose in managing the crisis; however, they also bring certain risks to the banking sector, since they threaten to mask underperformance of loans and defer losses further into the future – particularly if they are applied over too long a period. Also, they negatively impact the cash inflows and liquidity positions of banks.

We are well aware of these risks and proactively manage them with a continued focus on tight relationships with clients and transparency in terms of monitoring and reporting on real credit risk. Our carefully selected client base allows us to take an individual, differentiated approach to addressing the position of each client. Our Business Client Advisers manage on average portfolios of 40–50 loan clients. This means that they can monitor their portfolio regularly, and are at all times able to ask clients how their business is going or advise them on how to meet their banking needs.

For 2020 we see a phased approach to managing credit risk. In the first phase we will review all applications for moratoria individually and assess them carefully within a group-wide framework that is in line with ECB recommendations. In a second phase, which will likely fall into the second half of this year, we will restructure exposures that continue to be distressed. A sound and differentiated approach to restructuring will be instrumental to minimise levels of client default, which in turn will be the third phase. Here we feel very reassured of the overall strong collateralisation of our portfolio, which is foremost based on residential and commercial mortgages as well as cash and financial guarantees. As of today's date we feel no strong pressure on loan portfolio quality. Nevertheless, we are aware that the pandemic is only in its early stage and will accompany us all for quite some time. In particular, at the present time it is too early to predict the potential long-term economic consequences.

Restructuring exposures effectively requires in-depth understanding of the clients' businesses. Our Business Client Advisers and credit risk specialists are highly trained – many of them have gone through several years of training in our ProCredit Academy – and are well versed in maintaining relationships with their clients.

Similarly, in terms of managing liquidity and funding needs, our starting point is a solid one. Emerging market depositors can react nervously when banking sectors are under stress. Furthermore, delayed loan repayments can reduce liquidity. Our deposit to loan ratio further strengthened over 2019, and we ended the year with an LCR of 198%. So far this year we have seen some familiar seasonal drop in deposits, but beyond that, our deposit base has remained remarkably stable. So far it generally appears that our deposit volumes in these uncertain times will be supported by our close relationships to our clients and the market reputation we enjoy for being "German and solid". Coupled with our attractive direct banking offer, we see potential to attract new "digital" deposit clients in 2020. We have strong relations with international financial institutions and plan to draw on additional funding to support clients with short-term bridge-financing requests.

Overall, whilst we will continue to have a strict eye on prudent risk management, we will take advantage of any business opportunities that present themselves. We already see potential clients approaching us, since our steady service quality and our intensive client communication as well as continued access to lending are now especially visible.

Again, the quality and experience of our staff will be central to managing risks and opportunities in 2020. We have facilitated effective and flexible remote working arrangements for our employees as far as possible. Furthermore, as everyone adjusts to the "new normal" of high uncertainty and remote communication, our sense is that what characterises the ProCredit group way of working – flat hierarchies, a straightforward and direct way of addressing problems and finding common solutions, our shared values – is increasingly helping individuals and teams to stay connected and engaged, even with the possible limitations of a video call. We can also draw on our many years' experience in our markets and in managing volatility. Most of our managers went through the 2008/09 financial crisis with us. Therefore, overall confidence amongst our staff and managers remains strong, despite the challenges faced. This helps us to move forward in a coordinated and determined manner.

Outlook

In principle, we still see a certain potential to grow, particularly as clients are increasingly seeking shorter-term bridge funding. Further, there will be some clients that expand under the new market conditions, particularly in the agricultural and renewable energy sectors. Overall, we see good opportunities to attract new clients.

We continue to anticipate a positive return on equity for this year, taking into account a significant credit risk cost buffer in order to accommodate for the subdued economic outlook, anticipated restructurings of exposures and some increase in the default portfolio. Operationally, we expect to benefit from the absence of one-off costs, which strongly impacted our results in 2019. Furthermore, we anticipate a stable cost base that will remain largely unaffected by the current downturn.

As always in times of turmoil there will also be opportunities: We believe that, especially this year, existing and potential clients will see the value of ProCredit, also in the context of our competitive environment. In the midst of this crisis, where social justice and sustainable economy are moving more sharply into focus, we are convinced that our ethical business approach, which is aimed at bringing positive impact to our societies, now also has a clearly visible economic rationale.

Generally, we believe it is important to continue to take the long-term view for clients, shareholders and the societies in which we work. We will not look at 2020 in isolation. We aim to build on our strengths to ensure that our clients and our banks emerge stronger from this crisis. We remain confident in the mid-term prospects for our markets and for group performance. In this context, we have explicitly confirmed our medium-term targets and our commitment to our dividend policy.

This statement complements the information announced by the ProCredit group during the Analyst Conference Call on 26 March 2020. The ProCredit Group Annual Report 2019, the FY 2019 Results Presentation for Analysts and a recording of the Analyst Conference Call are available from the Investor Relations section of ProCredit Holding's website https://procredit-holding.com/investor-relations/reports-and-publications. The ProCredit group's Q1 2020 report will be published on 14 May 2020 as planned.

Forward-looking statements