EDISON

ProCredit Holding

Q222 results

Annualised ROE ex-Ukraine of 9.5% in H122

Banks

ProCredit Holding (PCB) continues to incur high loss allowances in Ukraine, booking €21.2m in Q222 versus €35.3m in Q122. However, ProCredit Bank Ukraine's operations are mostly uninterrupted, with its CET-1 ratio 4pp above the regulatory requirement at end-June 2022. PCB's operations outside Ukraine benefitted from solid loan book growth and a higher net interest margin (NIM), which coupled with a marginal cost of risk translated into an annualised return on equity (ROE) of 9.5% in H122 (close to the mid-term target of 10%). PCB's shares trade at c 0.23x FY22e book value (P/BV).

Year end	Net interest income (€m)	EPS (€)	DPS (€)	P/BV (x)	P/E (x)	ROE (%)	Yield (%)
12/20	201.6	0.70	0.53	0.3	5.0	5.3	15.2
12/21	222.0	1.35	0.00	0.2	2.6	9.7	0.0
12/22e	254.7	0.40	0.00	0.2	8.8	2.7	0.0
12/23e	279.5	1.42	0.47	0.2	2.5	8.9	13.6

Source: ProCredit Holding, Edison Investment Research; Note: EPS as reported by the company.

Benign market conditions outside Ukraine in Q222

PCB reported a 24.1% y-o-y increase in operating income before loss allowances to €82.5m, assisted by a 20% y-o-y increase in net interest income (NII) on the back of a 4.4% q-o-q increase in the loan book in Q222 and a higher NIM of 3.1% (2.9% in Q221). Q222 earnings were further supported by 12.7% y-o-y growth in net fee and commission income. This allowed PCB to further realise its scaling potential, leading to an improvement in its cost-income ratio (CIR) to 61.0% in Q222 versus 64.0% in Q221. PCB's CET-1 ratio at end-June 2022 was 13.7% versus a regulatory requirement of 8.2%.

Provisioning in Ukraine continues

PCB's cost of risk reached 188bp in H122, almost entirely due to Ukraine, driven by transfers to Stage 2 (35% of the local loan book at end-June 2022) and Stage 3 (ie credit-impaired loans, 4.8%). Consequently, 10% of the entire Ukrainian loan portfolio was covered by provisions (excluding guarantees and collateral) and the Stage 3 coverage ratio reached 55.6%. Q222 provisions at the group level were up c 8% versus our earlier assumptions and we now forecast €94.2m in FY22 (up from €88.1m). Loss allowances offset the strong increase in operating income, translating into Q222 group net profit of €9.4m (€20.7m in Q221).

Valuation: Trading at only 0.23x FY22e P/BV

Our fair value estimate for PCB now stands at €10.60 per share (versus €10.00 previously), implying upside potential of c 200%. Assuming a potential default by ProCredit Bank Ukraine, we arrive at a fair value of €9.40 per share. Consequently, we believe that investors overreacted to the risks for PCB associated with the outbreak of the war in Ukraine.

17 August 2022

Price	**€3.48**
Market cap	**€205m**

Total assets (€bn) at end-March 2022	8.2
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	(3.6)	(15.1)	(53.6)
Rel (local)	(10.8)	(14.8)	(46.9)
52-week high/low		€8.60	€3.26

Business description

ProCredit Holding is a Germany-based group operating regional banks across South Eastern and Eastern Europe and Ecuador. The banks focus on SMEs and private middle-income and high earners

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Edison profile page

ProCredit Holding is a research client of Edison Investment Research Limited

Q222 results: Modest profit despite further provisions in Ukraine

PCB reported a net profit of €9.4m in Q222 (€20.7m in Q221), as the 24.1% y-o-y increase in operating income to €82.5m (excluding provisions for credit losses) was offset by higher loss allowances at €21.7m (versus a minor positive P&L impact of €0.9m from loss allowances in Q221). The vast majority (c €21.2m in Q222) of these provisions are related to PCB's operations in Ukraine (the company also booked €35.3m in loss allowances in Q122). Excluding ProCredit Bank Ukraine, PCB's net profit would have been €42.0m in H122 (up 64% y-o-y, with a positive contribution from all local banks), implying an annualised ROE of 9.5% (close to PCB's reaffirmed mid-term target of 10%) versus 6.5% for PCB excluding Ukraine in H121.

Exhibit 1: Q222 results highlights

€m, unless otherwise stated	Q222	Q221	y-o-y change	H122	H121	y-o-y change
Net interest income	64.7	53.9	20.0%	124.8	103.2	21.0%
Net interest margin (%, annualised)	3.1	2.9	27bp	3.0	2.8	21bp
Expenses for loss allowances	21.7	(0.9)	N/M	57.3	2.7	N/M
Cost of risk (annualised, bp)	141	(6)	148bp	188	10	178bp
Net fee and commission income	13.7	12.1	12.7%	26.3	24.1	9.1%
Pre-tax profit	10.4	24.8	-58.0%	6.6	43.3	-84.7%
Net income	**9.4**	**20.7**	**-54.6%**	**7.7**	**36.4**	**-78.8%**
CIR (%)	61.0	64.0	-301bp	60.1	64.4	-431bp
CET-1 ratio (%)	13.7	13.7	0pp	13.7	13.7	0pp
Gross loan portfolio growth (% q-o-q)	4.4	4.5	-0.1pp	6.2	7.7	-1.4pp
Customer deposits growth (% q-o-q)	4.1	0.0	4.1pp	3.6	2.5	1.1pp

Source: ProCredit Holding, Edison Investment Research

NII up 20% y-o-y on higher NIM and loan book growth

PCB's NII increased by a solid 20% to €64.7m in Q222, driven by a combination of higher NIM (3.1% in Q222 versus 2.9% in Q221) and continued robust loan book growth of 4.4% q-o-q in Q222, bringing the growth between end-2021 and end-June 2022 to 6.2% (4.7% if adjusted for foreign exchange (fx) changes) and y-o-y growth to 11.3%. Meanwhile, net fee and commission income rose by 12.7% y-o-y to €13.7m in Q222, assisted by the continued increase in the client base and in volumes (most notably in the transaction and credit card business).

PCB's NIM benefitted from stable lending margins, an increase in base rates across several of the company's countries of operations and a higher share of sight deposits and FlexSave deposits (up 2.1pp y-o-y to 71%). Overall, in Q222 customer deposits increased by 4.1% q-o-q and 14.3% y-o-y. All loan categories contributed to the loan portfolio growth, but the major driver was working capital loans with maturities of up to three years (c 52% of Q222 growth, according to our calculations) as clients funded their additional working capital requirements arising from high inflation and supply chain bottlenecks (which encouraged SMEs to build up larger inventories). Green loans were up c 4.4% in Q222, with their share in the total loan book broadly unchanged versus the end-March 2022 figure of 19.1% (close to PCB's mid-term target of 20%).

Growth in Eastern Europe was largely due to fx effects, but we note that this was in part due to the Ukrainian hryvnia (UAH) being pegged to US dollar since the start of the Russian invasion, coupled with the US dollar appreciation versus the euro. Here, we note that the Ukrainian Central Bank devalued the hryvnia by 25% versus the US dollar in July 2022. Some additional positive fx impact in Q222 came from the appreciation of the Georgian lari. Almost all new loans in Ukraine in Q222 (€69m) were loans to agricultural clients utilising state and European Bank for Reconstruction and Development guarantees.

CIR improved to 61.0% in Q222 from 64.0% in Q221

PCB made further progress on its efforts to bringing its CIR below 60%, in line with its mid-term target. The company's CIR reached 61.0% in Q222, down 3pp y-o-y, as growth in its operating income outpaced the 11.7% y-o-y rise in personnel expenses to €23.6m and broadly in line with the 24.8% y-o-y increase in administrative expenses to €26.7m. We note that the latter includes €2.9m of one-off legal, advisory and audit fees related to the war in Ukraine, adjusted for which the growth in administrative expenses was 11.2% y-o-y in Q222. Moreover, PCB's net other operating income in Q222 contained a €1.9m extraordinary income from derivatives and a €0.8m negative impact related to a full write-down of goodwill in Ukraine. Adjusted for all the above one-off items, PCB's CIR stood at 58.3% in Q222, according to our calculations. Finally, PCB's net other operating income in the second quarter of the year included seasonally higher deposit insurance contributions, amounting to €1.5m.

Cost of risk burdened by provisions in Ukraine

PCB's high annualised cost of risk of 188bp in H122 (and 141bp annualised in Q222 alone) primarily reflects stage transfers within the Ukrainian portfolio, with Stage 2 loans representing approximately 35% of the local loan book and Stage 3 (credit-impaired) loans 4.8% at end-June 2022 (resulting in the group share of credit-impaired loans increasing to 2.6% vs 2.3% at end-March 2022 and end-2021). Despite the nationwide credit moratorium currently in place, PCB classifies loans with no repayments (neither interest nor principal) as credit impaired. At present, over 70% of Ukrainian customers make their planned interest payments, while more than 20% also make their planned principal repayments.

As a result, 10% of the Ukrainian loan portfolio was covered by provisions at end-June 2022 (excluding guarantees and collateral), with the Stage 3 loans coverage ratio now standing at 55.6%. PCB's provisioning at end-June 2022 includes €30.1m of management overlays, of which €13.7m is attributable to a higher loss given default (LGD) assumption in Ukraine (PCB extrapolated the LGD of its Donetsk portfolio in 2014–15 to the entire portfolio in Ukraine). The remaining €16.4m accounts for potential macro headwinds outside of Ukraine. Management highlighted that PCB's cumulative cost of risk related to Ukraine was at the upper end of the provisioning level of local peers (12.2% annualised cost of risk in H122 based on local regulatory reporting versus 6.2–14.6% for a set of undisclosed comparable companies). Excluding Ukraine, the cost of risk was marginal at €0.8m or 3bp in Q222 and the share of credit-impaired loans declined slightly.

Retaining a robust capital buffer with a CET-1 ratio of 13.7%

The group's capital base remained solid with a CET-1 ratio of 13.7% at end-June 2022 (14.1% at end-2021), well above the regulatory requirement of 8.2%. The increase from 13.4% at end-March 2022 was largely due to the recognition of Q421 profits and the reversal of dividend accruals related to 2021 earnings (the general meeting of shareholders accepted PCB's proposal not to distribute a dividend for 2021 in response to the outbreak of the war). The CET-1 ratio at end-June 2022 does not reflect Q222 profits or the adjustment to the official hryvnia exchange rate (see above), though management expects the latter will have a minimal negative impact (3bp). PCB's leverage ratio was 9.7% at end-June 2022.

ProCredit Bank Ukraine's CET-1 ratio at end-June 2022 was 4pp above the regulatory requirement (which we understand is 7.0% at present). As discussed in our previous note, while the credit losses of the Ukrainian bank may at some stage lead to a decline in its CET-1 ratio below the regulatory requirement, we note that the National Bank of Ukraine stated that in these instances it will allow banks to continue to operate so they can gradually rebuild their capital buffers. PCB considers the risk of a default by ProCredit Bank Ukraine is low. Still, it recently proposed to its lenders a change in the cross-default clauses of its bearer bonds, registered bonds, promissory notes and a senior loan of an aggregate value of €289.5m. If agreed, the change would exclude ProCredit Bank Ukraine from the list of PCB's material subsidiaries (from 1 July 2022 for two years), whose default is subject to special termination rights to investors. In exchange for agreeing to this exclusion, investors would receive a fee of 50bp pa. We understand that investors have until 22 August to accept the offer and subsequently the company will likely update the market with this respect. Fitch recently highlighted that the change in debt terms would have no impact on PCB's credit rating (its Long-Term Issuer Credit Rating is BBB with a stable outlook). Moreover, Fitch believes that even a failure to receive consent would not result in a material increase of default risk for PCB.

Forecast revisions

Minor changes to our PCB forecasts include higher loss allowances for the Eastern Europe segment in FY22e (€85.9m vs €75.7m previously), largely offset by lower credit loss provisions in South Eastern Europe (€5.2m vs €10.0m previously) and some slight upward revisions to our group net interest income and net fee and commission income forecasts. Management continues to expect a significant decrease in PCB's ROE in 2022 versus the prior year (we forecast an ROE at 2.7% in FY22e vs 9.7% in FY21). It is now guiding to a CIR of 60–63% in 2022 (vs 64.4% in 2021), based on the strong efficiency improvements in H122 (we have factored in 63.0% vs 63.6% previously). Moreover, PCB expects the group loan book to increase at a high-single digit percentage rate in FY22 (after adjusting for currency effects), compared with our estimate of 8.6% (including a positive fx impact at c 0.7pp). We note that management intends to prioritise the growth in customer deposit and enhancing its NIM over loan book growth on the near term. Finally, management anticipates a CET-1 and leverage ratio of around 13.0% and 9.0% in FY22e, respectively. Our CET-1 forecast for FY22e is somewhat higher at 13.5% (14.1% at end-2021).

Management confirmed its mid-term guidance of a c 10% ROE (which we expect to be reached in c FY24–25e) and a CIR below 60% (we assume that PCB will gradually approach the 60% mark between now and FY26e). In terms of loan book growth, the company expects an annual loan portfolio growth rate in the mid- to upper-single digit percentage range. We have conservatively factored in 3.0% growth in FY23e (due to the recessionary environment) followed by 9.1% in FY24e and c 10% in FY25e and FY26e.

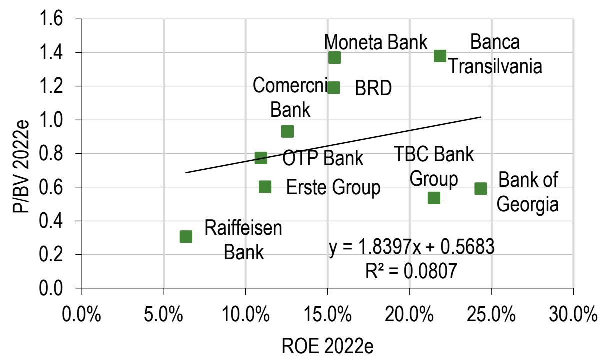
Exhibit 2: Forecast revisions

	2021	2022e				2023e			
€m, unless otherwise stated	**Actual**	**Old**	**New**	**Change**	**growth y-o-y**	**Old**	**New**	**Change**	**growth y-o-y**
Net interest income	222.0	251.3	254.7	1.4%	14.7%	278.1	279.5	0.5%	9.8%
Net interest margin (%, annualised)	2.9	3.0	3.0	0.1 pp	0.1 pp	3.1	3.2	0 pp	0 pp
Expenses for loss allowances	6.5	88.1	94.2	6.8%	NM	26.3	26.6	1.1%	-71.8%
Cost of risk (annualised in bp)	12	142	152	10 bp	NM	40	41	1 bp	-112 bp
Net fee and commission income	50.9	53.3	55.8	4.6%	9.7%	56.3	59.0	4.8%	5.8%
Pre-tax profit	94.5	25.5	25.0	-1.9%	-73.6%	98.0	98.9	0.9%	295.5%
Net income	**79.6**	**22.9**	**23.4**	**2.0%**	**-70.6%**	**82.5**	**83.6**	**1.4%**	**257.5%**
CET1 ratio (%)	14.1	13.2	13.5	0.3 pp	-0.6 pp	13.0	13.5	0.5 pp	0 pp
Total capital ratio (%)	15.3	14.1	14.4	0.3 pp	-0.9 pp	13.9	14.4	0.5 pp	-0.1 pp
CIR (%)	64.2	63.6	63.0	-0.6 pp	-1.2 pp	63.6	63.0	-0.6 pp	0 pp
Gross loan portfolio	5,924.4	6,478.6	6,431.3	-0.7%	8.6%	6,669.8	6,622.0	-0.7%	3.0%
Net loan portfolio	5,793.0	6,271.5	6,211.4	-1.0%	7.2%	6,481.7	6,427.9	-0.8%	3.5%
Customer deposits	5,542.3	6,043.7	5,964.8	-1.3%	7.6%	6,444.5	6,267.7	-2.7%	5.1%

Source: ProCredit Holding, Edison Investment Research

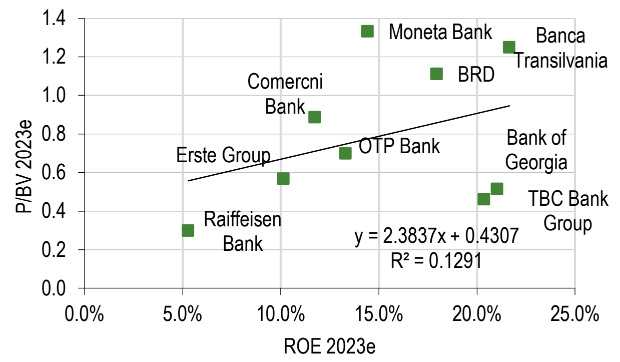
Regression lines based on FY22e and FY23e P/BV and ROE indicators for PCB's peers imply a P/BV (for PCB's sustainable return on tangible equity of 10%) at 0.71x (see Exhibits 3 and 4), which is slightly ahead of the 0.66x in our previous note. As a result, we have assumed a fair value multiple of 0.74x (0.72x previously), which is the average of the 0.77x multiple derived from our capital asset pricing model and the regression analysis (see our previous note for details). This implies a fair value per PCB share of €10.60 (versus the current share price of €3.48). 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.

Exhibit 3: P/BV versus ROE – PCB's peers (2022e)



Source: Refinitiv consensus at 17 August 2022

Exhibit 4: P/BV versus ROE – PCB's peers (2023e)



Source: Refinitiv consensus at 17 August 2022

Exhibit 3: Financial summary

YE December, in €000's unless otherwise stated	2018	2019	2020	2021	2022e	2023e	2024e	2025e	2026e
Income Statement									
Net interest income	186,235	194,533	201,561	222,021	254,669	279,523	289,825	308,151	333,235
Net fee and commission income	52,172	51,972	47,380	50,855	55,763	59,013	62,716	66,696	70,893
Operating income	240,678	249,275	252,114	281,881	321,818	341,045	358,752	382,515	413,493
Operating expenses	167,866	175,737	171,430	180,859	202,666	215,605	226,755	238,319	250,478
Loss allowances (-)	(4,714)	(3,327)	28,600	6,490	94,158	26,581	16,826	16,427	18,293
PBT	**77,526**	**76,865**	**52,084**	**94,532**	**24,994**	**98,859**	**115,171**	**127,769**	**144,722**
Net profit after tax	**54,477**	**54,304**	**41,395**	**79,641**	23,394	83,639	97,320	108,286	122,749
Reported EPS (€)	**0.90**	**0.89**	**0.70**	**1.35**	0.40	1.42	1.65	1.84	2.08
DPS (€)	0.30	0.00	0.53	0.00	0.00	0.47	0.55	0.61	0.69
Balance Sheet									
Cash and balances at Central Banks	963,714	1,081,723	1,405,349	1,545,523	1,541,651	1,709,801	1,784,698	1,891,047	2,001,791
Loans and advances to banks	211,592	320,737	236,519	252,649	252,649	252,649	252,649	252,649	252,649
Investment securities	297,308	378,281	336,476	410,400	361,152	361,152	361,152	361,152	361,152
Loans and advances to customers	4,267,829	4,690,961	5,131,582	5,792,966	6,211,416	6,427,921	7,052,380	7,762,445	8,548,413
Property, plant and equipment and investment properties	130,153	138,407	140,744	137,536	142,501	142,501	142,501	142,501	142,501
Intangible assets	22,191	20,345	19,316	18,411	17,668	17,668	17,668	17,668	17,668
Other assets	73,396	67,106	59,315	58,416	78,898	70,001	78,898	70,001	78,898
Total assets	**5,966,184**	**6,697,560**	**7,329,301**	**8,215,901**	**8,605,935**	**8,981,692**	**9,689,946**	**10,497,462**	**11,403,072**
Liabilities to banks	1,014,182	1,079,271	1,235,763	1,313,666	1,313,666	1,300,529	1,404,572	1,460,755	1,533,792
Liabilities to customers	3,825,938	4,333,436	4,898,897	5,542,251	5,964,754	6,267,712	6,802,483	7,477,971	8,223,889
Debt securities	206,212	343,727	266,858	353,221	276,990	276,990	276,990	276,990	276,990
Subordinated debt	143,140	87,198	84,974	87,390	88,913	88,913	88,913	88,913	88,913
Other liabilities	33,076	50,436	63,080	63,059	66,340	66,340	66,340	66,340	66,340
Total liabilities	**5,222,549**	**5,894,068**	**6,549,573**	**7,359,587**	**7,710,663**	**8,000,484**	**8,639,298**	**9,370,969**	**10,189,925**
Total shareholders' equity	**743,634**	**803,492**	**779,728**	**856,314**	**895,272**	**981,208**	**1,050,648**	**1,126,493**	**1,213,147**
BVPS	12.5	13.5	13.2	14.5	15.2	16.7	17.8	19.1	20.6
TNAV per share	12.1	13.1	12.9	14.2	14.9	16.4	17.5	18.8	20.3
Ratios									
NIM	3.30%	3.10%	2.90%	2.90%	3.03%	3.18%	3.10%	3.05%	3.04%
Costs/Income	69.7%	70.5%	68.0%	64.2%	63.0%	63.2%	63.2%	62.3%	60.6%
ROAE	7.6%	6.9%	5.3%	9.7%	2.7%	8.9%	9.6%	9.9%	10.5%
CET1 Ratio	14.4%	14.1%	13.3%	14.1%	13.5%	13.5%	13.0%	12.8%	12.7%
Tier 1 ratio	14.4%	14.1%	13.3%	14.1%	13.5%	13.5%	13.0%	12.8%	12.7%
Capital adequacy ratio	17.2%	15.7%	14.7%	15.3%	14.4%	14.4%	13.7%	13.5%	13.3%
Payout ratio (%)	33.3%	0.0%*	33.3%*	0.0%	0.0%	33.3%	33.3%	33.3%	33.3%
Customer loans/Total assets	73.6%	71.6%	71.7%	72.1%	74.7%	73.7%	74.5%	75.7%	76.6%
Loans/Deposits	114.8%	110.7%	107.3%	107.0%	107.8%	105.7%	106.2%	106.2%	106.3%

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

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