ProCredit Holding

Q320 results

Promising Q320 figures

Banks

ProCredit Holding (PCB) reported Q320 profit after tax of €11.7m (down from €21.5m profit from continued operations in Q319), which was primarily due to higher loss provisions and lower net fee and commission income year-on-year (y-o-y) driven by the COVID-19 crisis. However, we note that both gross loan book and deposit base growth remain strong, while the year to date run-rate for PCB's cost of risk (56bp annualised) and its cost income ratio (66.5%) are slightly better than management's expectations. Furthermore, its net interest margin (NIM) remained stable vs Q220 at 2.9%, which together with the robust lending activity resulted in a net interest income close to Q319 levels (€50.8m vs €51.0m last year).

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV (x)	P/E (x)	ROE (%)	Yield (%)
12/18	186.2	0.90	0.30	0.5	6.8	7.6%	4.9
12/19	194.5	0.89	0.00	0.5	6.9	6.9%	0.0
12/20e	202.6	0.70	0.53	0.5	8.7	5.2%	8.7
12/21e	208.0	0.87	0.29	0.4	7.0	6.4%	4.8

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

Cost of risk low in Q320, though may be up in Q420

PCB posted an annualised cost of risk of 42bp in Q320 (compared to 71bp in Q220), which was largely driven by transfers to stage 2 loans (now 6.6% of gross loan book) as a result of individual assessments of loan credit quality, as well as restructurings (with no further update of macro assumptions, which will take place in Q420). Meanwhile, the share of credit-impaired loans to gross loan book remains low at 2.3% (vs 2.5% in Q220) and is even lower for PCB's green loans at 0.3%. While the Q420 outlook is uncertain amid the second COVID-19 wave, management believes that FY20 cost of risk may be below the previous guidance of 75bp (with no significant increase in default rate).

NIM assisted by growing loan book and deposits

Although PCB's NIM in Q320 was down y-o-y from 3.2% in Q319 amid widespread rate cuts, it was stable vs Q220 at 2.9%. This has been supported by solid growth in loan book (3.0% during the quarter) and deposits (6.1%, in particular sight deposits), with most repricing on the asset side offset by a repricing on the liabilities side in Q320. We particularly underline the fact that loan book growth was driven exclusively by investment loans, including green loans. The latter now represent 18.3% of total gross loan book at end Q320 (vs PCB's mid-term target of 20%).

Valuation: Still undemanding

Despite the strong share price increase on the day of PCB's Q320 results release (stock up c 10%), its shares now trade at an FY20e P/BV ratio of 0.5x vs the peer average of 1.0x, which we believe is only partially justified by PCB's lower return on equity (ROE). Our valuation currently stands at €8.00/share, implying c 31% upside potential. Management will propose not to pay a dividend from FY19 earnings this year, but intends to pay one-third of both FY19 and FY20 profits in 2021 (subject to the prevailing recommendations of supervisory authorities).

23 November 2020

Price	**€6.10**
Market cap	**€359m**

Total assets (€bn) at end-September 2020	7.1
Shares in issue	58.9m
Free float	35.7%
Code	PCZ
Primary exchange	Frankfurt Prime Standard
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	19.0	2.6	(21.7)
Rel (local)	15.4	0.2	(21.6)
52-week high/low		€7.50	€4.60

Business description

ProCredit Holding is a Germany-based group operating regional banks across Southeastern and Eastern Europe, as well as in Ecuador. The banks focus on small and mid-size enterprises (SMEs) and private middle-income and high earners. At end-September 2020, the group's total assets stood at €7.1bn.

Next events

Extraordinary general meeting	10 December 2020

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Q320 results: Positive drivers on multiple fronts

We compare PCB's Q320 results with our estimates and Q319 numbers in the exhibit below. PCB's net profit in Q320 reached €11.7m (vs €21.1m in Q319), translating into 9M20 profit after tax of €33.4m (vs €45.9m from continuing operations in 9M19).

Exhibit 1: Q320 results review

€m, unless otherwise stated	Q320	Q320e	% diff	Q319	y-o-y change
Net interest income	50.8	47.1	7.9%	51.0	-0.3%
Net interest margin (annualized)	2.9%	2.7%	0.2 pp	3.2%	-0.3 pp
Expenses for loss allowances	5.4	11.9	N/M	-1.7	N/M
Cost of risk (annualized)	42.0	93.0	N/M	N/M	N/M
Net fee and commission income	12.1	11.8	2.2%	13.1	-7.4%
Pre-tax profit	15.8	6.9	128.1%	25.5	-38.1%
Net income	**11.7**	**5.6**	**110.3%**	**21.1**	**-44.5%**
CIR	66.7%	68.5%	-1.8 pp	64.2%	2.4 pp
Gross loan portfolio	5,205.2	5,184.4	0.4%	4,710.0	10.5%
Customer deposits	4,717.6	4,548.5	3.7%	4,143.0	13.9%

Source: ProCredit Holding data, Edison Investment Research

Gross loan book up 8.5% ytd, suggesting FY20 growth at the upper end of the guided 8–10%

PCB continued to achieve solid loan book growth with a 3.0% increase in Q320 vs Q220, resulting in 8.5% year-to-date growth. As this is already within the range guided by management for FY20 (8–10%), the company expects the full year increase to be closer to the upper bound (though the second COVID-19 wave obviously constitutes a risk factor for Q420). This was despite the currency headwinds from the depreciation of the Ukrainian hryvna and Georgian lari vs the euro by c 10% during the quarter, resulting in a slight 1% decline in the Eastern Europe loan book in Q320. Some positive impact again came from moratoria (due to suspension of principal repayments), though it was less pronounced than in Q220 given the lower proportion of loans under moratoria (see below).

It is worth highlighting that Q320 growth came exclusively from longer-term investment loans (as opposed to working capital loans), including green loans, with the latter increasing by 9.1% in Q320 (19.9% year-to-date, accounting for 39% of loan book growth so far this year). Consequently, PCB's green loan portfolio as a percentage of the total loan book increased further to 18.3% from 17.3% in Q220 and 16.6% at end-2019 (well on track to reach the mid-term target of 20%). Overall, PCB's growth continued to be focused to a greater extent on the upper medium business segment.

Deposit base expansion coupled with a growing number of customers

PCB recorded a particularly strong sequential expansion in deposit base of 6.1% in Q320 (vs our estimate of 2.3%), bringing the year-to-date improvement to 8.9%. Growth came especially from Bulgaria, Serbia and Romania. This has been likely assisted by PCB's digital platform and has been accompanied by steady growth in the number of customers (contrary to last year when PCB saw a reduction in the number of non-core clients). This, together with an increase in liabilities to international financial institutions, allowed the bank to reduce its reliance on interbank financing, with liabilities to banks declining by 3.5% year-to-date to €218.9m at end-September 2020. The increase vs Q319 came primarily from sight deposits and FlexSave savings accounts, which means that a higher proportion of PCB's deposit base has lower withdrawal restrictions. At the same however, this had a positive impact on PCB's interest expense and net interest margin (see below).

Cost of risk below management and our expectations in Q320

Annualised cost of risk stood at 42bp in Q320 (56bp year-to-date), which was slightly below management expectations. Management has now flagged that the FY20 figure may potentially be below the initially guided c 75bp and that the Q420 figure may be in the same order of magnitude as Q220 (when it reached 71bp).

While the market environment remains difficult to predict, especially amid the second COVID-19 wave and the reintroduction of lockdown measures, management does not expect a significant increase in the default rate in Q420 (based on the current loan book assessment). Defaults remained limited in Q320, with the share of credit-impaired loans in the total gross book at 2.3% (down from 2.5% in Q220), including 0.3% in the case of green loans. In Eastern Europe alone, the ratio declined to 2.4% from 2.8% in Q220. At the same time, we note that PCB's non-performing loan (NPL) coverage ratio stood at a robust 98.5% (vs 89.1% at end-2019). Moreover, PCB had €3.8bn in collateral, mainly mortgages (65%), at end-September 2020.

We understand that there was only a moderate uptick in restructuring processes in Q320 (especially in Ecuador). This trend is especially important as PCB's portfolio under moratoria continued to decline to 12.6% at end-September 2020 (from c 17% at end-June 2020 and c 30% at end-March 2020) amid expiring moratoria in several countries. As these expired in Serbia at end-September, this number declined further to below 5% as at 1 October 2020 (representing a volume of c €250m). PCB highlighted in its Q320 report that it carried out additional credit analysis to identify any increase in credit risk, especially for loans under moratoria (with the process 'almost completed' at end-September 2020). The company did not create additional loss allowances on the back of updated macroeconomic assumptions in Q320, but an update is expected in Q420 following the publication of the new IMF Economic Outlook in October. Consequently, we assume that most of the loss provisions created in Q420 will come from stage 2 provisions and expect that the cost of risk will increase to 85bp in Q420 from 42bp in Q320. In Q320, stage 2 loans represented 6.6% of the gross loan book (up from 5.3% in Q220). However, we do not expect an increase in the ratio of credit-impaired loans (ie stage 3) to gross loan book in Q420.

NIM stable sequentially in Q320 at a level management deems sustainable

It is particularly worth noting that PCB's NIM stabilised sequentially in Q320 at 2.9%, which has been supported by solid deposit and loan book growth, with most repricing on the asset side offset by a repricing on the liabilities side in Q320. PCB highlighted that it experienced a stable or upward trend in NIM across the majority of its countries of operations (with Ukraine being the main exception due to strong rate cuts recently). We understand that management believes the current NIM level is sustainable.

PCB's net fee and commission income stood at €12.1m, down c 8% y-o-y from €13.1m in Q319, but visibly recovering from Q220 (€10.6m) as customer activity in terms of transaction volume normalised. Fee income from account maintenance increased slightly on the back of the expanding customer base.

CIR now expected slightly below previous FY20 guidance of c 70%.

The bank's cost-income ratio (CIR) came in at 66.7% in Q320 (first nine months of 2020 (9M20): 66.5%) compared to FY20 guidance of c 70%. This is the result of stable operating expenses and improving operating income. Personnel expenses remained flat during the quarter and we understand that the budgeted increase in headcount has already been completed, with no major expansion planned in the near term. We note that PCB's net other operating income and administrative expenses in Q420 will be negatively affected by a goodwill write-off (in Romania and Ecuador) and restructuring costs in its bank in Romania (including severance payments and costs of branch closures). These will amount in aggregate to a single-digit million euro amount. According to management, these resulted from COVID-19 prolonging the recovery in the bank's profitability. PCB's management now expects the group CIR to be slightly below the original full-year guidance.

Capital base remains robust

PCB's capital ratio remained solid, with the CET-1 ratio at 14.1% and a total capital ratio (TCR) of 15.7% (both stable vs end-2019). CET-1 capital includes profits for Q120 and Q220, but at the same time was calculated after deduction of the assumed dividend payout of one-third of 2019 and H120 profits representing €25.0m in total. No incremental positive impact on risk weighted assets (RWA) was recognised in Q320 from the introduction of new SME parameters, with €140m already reflected at end-June 2020 and a further €110–120m expected by the company in the subsequent 12 months. The bank's liquidity coverage ratio (LCR) improved slightly to 149% at end-September 2020 vs 142% at end-June 2020 (and the regulatory requirement of 100%).

Forecast revisions

Following the release of what we believe are robust Q320 figures, we have made some changes to our PCB forecasts. We have reduced our FY20 cost of risk assumptions to 64bp from the previous 81bp, and also lowered our FY21 estimate to c 52bp. Moreover, we have slightly increased our gross loan book growth forecast for FY20 to 10.2% from 9.3% earlier. We have also made an upward revision to PCB's deposit growth in FY20 (given the year-to-date rise of 8.9%) and FY21. We now expect a NIM of 2.9% in FY20 (vs 2.8% earlier). We have reflected c €5m of one-off charges in Q420 related to Romania and Ecuador in line with management guidance. Nevertheless, our CIR forecast for FY20 declined slightly to 67.3% from 67.8% earlier. As a result, we now expect the bank's FY20 net profit to reach €41.3m (vs €31.5m previously), implying an ROE of 5.2% (4.0% previously). We currently assume no dividend payment from FY19 earnings in FY20 (in line with management's declaration a day before publication of the Q320 results).

Exhibit 2: Forecast revisions summary

€m, unless otherwise stated	2019	2020e				2021e			
	Actual	Old	New	Change	growth y-o-y	Old	New	Change	growth y-o-y
Net interest income	194.5	194.4	202.6	*4.2%*	*4.2%*	195.3	208.0	*6.5%*	*2.7%*
NIM (annualised)	3.1%	2.8%	2.9%	*0 pp*	*-0.2 pp*	2.8%	2.8%	*0 pp*	*-0.1 pp*
Expenses for loss allowances	-3.3	41.1	32.2	*-21.7%*	*N/M*	32.4	28.6	*-11.8%*	*-11.2%*
Cost of risk (annualised in bps)	N/M	81	64	*-17 bp*	*N/M*	60	52	*-8 bp*	*-12 bp*
Net fee and commission income	52.0	46.9	46.6	*-0.7%*	*-10.3%*	52.1	51.5	*-1.1%*	*10.5%*
Pre-tax profit	76.9	38.5	51.0	*32.5%*	*-33.6%*	50.0	64.0	*28.0%*	*25.5%*
Net income	**61.5***	**31.5**	**41.3**	***31.0%***	***-32.9%***	**39.8**	**51.4**	***29.3%***	***24.6%***
CET1 ratio	14.1%	14.2%	13.9%	*-0.3 pp*	*-0.3 pp*	14.5%	14.2%	*-0.3 pp*	*0.4 pp*
TCR	15.7%	15.8%	15.5%	*-0.3 pp*	*-0.2 pp*	16.1%	15.8%	*-0.3 pp*	*0.3 pp*
CIR	70.5%	67.8%	67.3%	*-0.5 pp*	*-3.2 pp*	67.6%	65.3%	*-2.3 pp*	*-1.9 pp*
Gross loan portfolio	4,797.3	5,245.0	5,287.5	*0.8%*	*10.2%*	5,612.7	5,662.2	*0.9%*	*7.1%*
Customer deposits	4,333.4	5,113.8	5,166.2	*1.0%*	*10.1%*	5,475.2	5,529.6	*1.0%*	*7.0%*

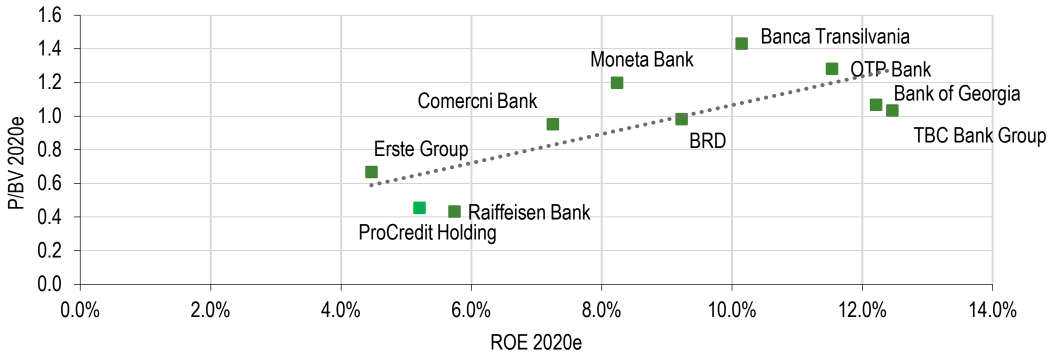
Source: ProCredit, Edison Investment Research. Note: *Profit from continuing operations.

Valuation

Following our FY20 forecast revisions and bringing the valuation forward (resulting in a lower discount factor), our PCB fair value estimate increased to €8.00 per share from €7.75 previously.

While PCB has one of the lowest FY20 ROEs in its peer group (c 5.2% based on our forecasts), it is also trading at one of the lowest price to book value (P/BV) ratios (0.5x) and as a result is positioned below the regression line in our P/BV-ROE landscape (see Exhibit 3). It is worth keeping in mind that the group is quite scattered across the P/BV-ROE map (eg Georgian banks are traded at quite low P/BV compared to their ROE) making the regression line somewhat less reliable.

Exhibit 3: P/BV vs ROE – ProCredit and its peers (2020e)



Source: ProCredit, Edison Investment Research forecasts for PCB, Refinitiv consensus at 20 November 2020

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Exhibit 4: Financial summary

Year ending 31 December (€000's unless otherwise stated)	FY17	FY18	FY19	FY20e	FY21e	FY22e	FY23e	FY24e
Income Statement								
Net interest income	204,664	186,235	194,533	202,634	208,042	223,530	245,034	268,479
Net fee and commission income	45,834	52,172	51,972	46,595	51,467	57,292	60,921	64,779
Loss allowances (-)	4,819	(4,714)	(3,327)	32,190	28,584	15,588	11,556	11,355
Operating income	248,414	245,394	252,603	222,115	238,692	274,364	305,325	334,845
Operating expenses	186,265	167,866	175,737	171,066	174,652	183,585	195,009	207,474
PBT	**62,150**	**77,528**	**76,866**	**51,049**	**64,041**	**90,779**	**110,316**	**127,371**
Net profit after tax	48,104	54,479	54,305	41,274	51,445	74,507	90,744	104,887
Reported EPS (€)	0.86	0.90	0.89	0.70	0.87	1.27	1.54	1.78
DPS (€)	0.27	0.30	0.00	0.53	0.29	0.42	0.51	0.59
Balance Sheet								
Cash and balances at Central Banks	932,744	963,714	1,081,723	1,394,201	1,355,175	1,427,367	1,507,339	1,591,033
Loans and advances to banks	195,552	211,592	320,737	228,233	232,798	232,798	232,798	232,798
Investment securities	353,568	297,308	378,281	350,535	357,546	357,546	357,546	357,546
Loans and advances to customers	3,756,776	4,267,829	4,690,961	5,166,232	5,529,595	6,087,346	6,702,571	7,385,373
Property, plant and equipment and investment properties	142,347	130,153	138,407	138,876	138,876	138,876	138,876	138,876
Intangible assets	21,153	22,191	20,345	20,645	20,645	20,645	20,645	20,645
Other assets	79,659	73,396	67,106	67,725	67,725	67,725	67,725	67,725
Total assets	**5,481,799**	**5,966,184**	**6,697,560**	**7,366,448**	**7,702,360**	**8,332,303**	**9,027,500**	**9,793,996**
Liabilities to banks	359,477	200,813	226,819	223,231	227,696	241,357	255,839	271,189
Liabilities to customers	3,571,237	3,825,938	4,333,436	4,905,951	5,197,110	5,694,605	6,244,299	6,851,786
Liabilities to international financial institutions	549,598	813,369	852,452	1,003,717	1,023,791	1,085,219	1,150,332	1,219,352
Debt securities	183,145	206,212	343,727	294,945	294,945	294,945	294,945	294,945
Subordinated debt	140,788	143,140	87,198	86,222	86,222	86,222	86,222	86,222
Other liabilities	37,714	33,076	50,436	59,882	59,882	59,882	59,882	59,882
Total liabilities	**4,841,961**	**5,222,549**	**5,894,068**	**6,573,947**	**6,889,645**	**7,462,230**	**8,091,519**	**8,783,375**
Total shareholders' equity	**639,839**	**743,634**	**803,492**	**792,500**	**812,714**	**870,073**	**935,981**	**1,010,620**
BVPS (€)	11.8	12.5	13.5	13.5	13.8	14.8	15.9	17.2
TNAV per share (€)	11.4	12.1	13.1	13.1	13.4	14.4	15.5	16.8
Ratios								
NIM	3.80%	3.30%	3.10%	2.88%	2.76%	2.79%	2.82%	2.85%
Costs/Income	73.6%	69.7%	70.5%	67.3%	65.3%	63.3%	61.5%	59.9%
ROAE	7.1%	7.6%	6.9%	5.2%	6.4%	8.9%	10.0%	10.8%
CET1 Ratio	13.7%	14.4%	14.1%	13.9%	14.2%	14.2%	14.2%	14.2%
Tier 1 ratio	13.7%	14.4%	14.1%	13.9%	14.2%	14.2%	14.2%	14.2%
Capital adequacy ratio	16.7%	17.2%	15.7%	15.5%	15.8%	15.7%	15.6%	15.5%
Payout ratio (%)	31.4%	33.3%	0.0%	33.3%	33.3%	33.3%	33.3%	33.3%
Customer loans/Total assets	71.3%	73.6%	71.6%	71.8%	73.5%	74.7%	75.8%	76.9%
Loans/Deposits	109.5%	114.8%	110.7%	107.8%	108.9%	109.3%	109.6%	109.9%

Source: Company data, Edison Investment Research

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