ProCredit Holding

New strategy targets ROE of 13–14%

Company outlook

Banks

ProCredit Holding (PCB) has decided to build on its recent solid performance (FY23 return on equity, ROE, of 12.2%) and announced an updated strategy to drive its ROE to 13–14% in the medium term. PCB's management aims to achieve this by becoming a universal bank for micro, small and medium-sized enterprises (with an increased focus on the lower end of the segment) and private individual clients. This should allow it to grow its loan book to more than €10bn, bring its deposit-to-loan ratio above 120% and offset the impact of declining base rates on its net interest margin (NIM) in the medium term. Management also aims to reach a cost-to-income ratio (CIR) of around 57%.

Year end	Net interest income (€m)	EPS* (€)	DPS (€)	P/BV (x)	P/E* (x)	ROE (%)	Dividend yield (%)
12/22	264.6	0.28	0.00	0.64	33.6	1.9	N/A
12/23	337.2	1.92	0.64	0.56	4.9	12.2	6.8
12/24e	365.9	1.94	0.65	0.52	4.9	11.2	6.9
12/25e	391.6	1.97	0.66	0.49	4.8	10.6	7.0

Note: *EPS as reported by the company

Higher near-term CIR due to strategy execution costs

PCB plans to lay the foundations for the new strategy by increasing its headcount by 25% (with an accompanying reconstruction of its retail teams), selectively expanding its branch network, as well as earmarking additional IT and marketing expenses. As a result, PCB's management initially expects a lower ROE at 10–12% and a temporary higher CIR of 63% in FY24e. Accordingly, we now forecast PCB's ROE at 11.2% and 10.6% in FY24e and FY25e, respectively. We expect PCB to return to its previous dividend policy of paying out one-third of its profits. Despite the strategy implementation cost, this would result in a healthy dividend yield of c 7% at the current share price.

Strengthening its sustainability profile

PCB's management expects the updated strategy to result in a greater sustainability impact in its countries of operations, given the more comprehensive service provided to micro-enterprises and private individuals (PI). PCB wants to maintain its appeal to retail clients via its impact story, community activities and green lending. It will now focus on five Sustainable Development Goals (SDGs): Gender Equality; Decent Work and Economic Growth; Industry, Innovation and Infrastructure; Affordable and Clean Energy; and Climate Action.

Valuation: Strong upside even at an RoTE of 11%

We have raised our fair value estimate for PCB's shares to €14.70 per share (compared to €13.00 previously), as we now use the forecast end-2024 tangible book value per share of €17.60 in our valuation (vs the end-2023 estimate of €16.40 previously). Our upward revision is also supported by the update to our country risk premiums, as well as higher peer multiples. We retain our sustainable return on tangible equity (RoTE) assumption of 11% for now. Reflecting PCB's targeted 13–14% profitability would bring our valuation to €17.20–18.50 per share.

29 April 2024

Price	**€9.42**
Market cap	**€555m**
Total assets (€bn) at end-2023	9.7
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	8.5	20.5	52.4
Rel (local)	9.9	12.5	32.6
52-week high/low		€9.42	€5.82

Business description

Based in Germany, ProCredit Holding operates regional banks across Southeastern and Eastern Europe and Ecuador. The banks focus on micro, small and medium-sized enterprises and private individuals.

Next events

Q124 results	13 May 2024
Equity Forum German Spring Conference	14–15 May 2024

Analyst

Milosz Papst +44 (0)20 3077 5700

financials@edisongroup.com

Edison profile page

ProCredit Holding is a research client of Edison Investment Research Limited

Investment summary

Company description: Sustainability play in the banking sector

PCB is a German-headquartered specialist micro, small and medium-sized enterprises (MSME) lender operating in emerging Europe – Southeastern (SEE) and Eastern Europe (EE) – and Ecuador, with a strong emphasis on sustainability and long-term relationships with its customers. The bank is among the top three lenders in the small and medium-sized enterprises (SME) segment across most of its markets. It recently updated its strategy to position itself as a universal bank for MSMEs and private individual clients.

Financials: Updated strategy to further drive profitability

Within its revised strategy, PCB now aims to reach an ROE of 13–14% in the medium term, which we consider achievable on a five-year horizon (see below for details). As a result, we have slightly raised our FY27 ROE forecast to 12.1%, versus 11.8% previously, and introduced an FY28e estimate of 13.3%. This improvement in profitability should be supported by scaling effects from an expanding loan book to more than €10bn (vs €6.2bn at end-2023). Moreover, PCB will focus on consolidating its margins through a more granular deposit base and loan book, as well as an improvement of the deposit-to-loan ratio to more than 120% across all its banks (vs 116.5% at group level at end-2023). In the short term, management guides to an ROE of 10–12% for FY24e due to the costs of implementing its strategy, including headcount growth, selective branch expansion, as well as additional IT and marketing expenses (we now forecast 11.2% and 10.6% in FY24e and FY25e, respectively, compared to 11.3% and 11.0% previously). Therefore, it guides to an FY24e CIR of 63% compared to c 60% at end-2023 and its mid-term target of 57% (we assume CIRs of 63% and 66% in FY24e and FY25e, respectively, compared to c 63% in each of these years previously). We note that PCB's management has a good track record of delivering on its guidance (in the absence of any 'black swan' events such as the war in Ukraine).

Valuation: Shares offer 56% upside potential

We have conservatively retained our sustainable RoTE assumption of 11% for now, as we do not expect management's ROE target to be reached within the next three years. That said, our fair value estimate has increased as we now reflect the end-2024 tangible book value of €17.60m, which remained broadly unchanged versus earlier forecasts (our previous valuation was based on the end-2023 figure). 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 1.00x (previously: 0.80x). We blend this with the ratio implied by the P/BV-ROE regression of PCB's peers for FY23 of 0.79x (previously: 0.68x). As a result, our current fair value estimate for PCB stands at €14.70 per share (vs €13.00 previously). If we assumed a sustainable RoTE of 13–14% (in line with management's mid-term target), this would yield a fair value of €17.20–18.50 per share.

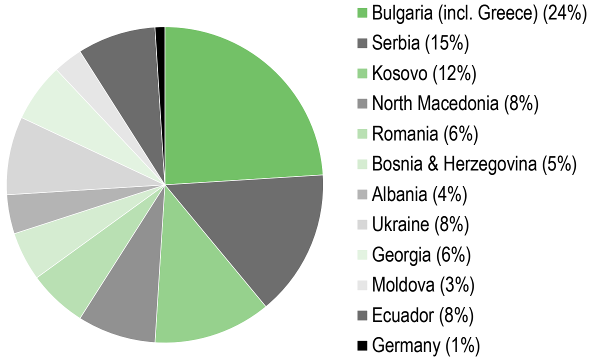
Sensitivities: Strategy execution, sociopolitical woes and EU's economy

Key risks to our forecasts and valuation include the execution risks associated with PCB's updated strategy, mostly around the further expansion in retail, the introduction of automated credit decisions and monitoring, expansion of the branch network and growth in the deposit-to-loan ratio. Moreover, the SEE/EE region is sensitive to the economic climate in Western Europe and is therefore dependent on the macroeconomic outlook in the European Union. Moreover, political instability is high in some countries (eg Ukraine, Ecuador, Moldova). A worst-case outcome of the war in Ukraine for PCB, leading to a default of the local bank, would yield a fair value per PCB share of €13.25.

Company description: Impact-oriented lender

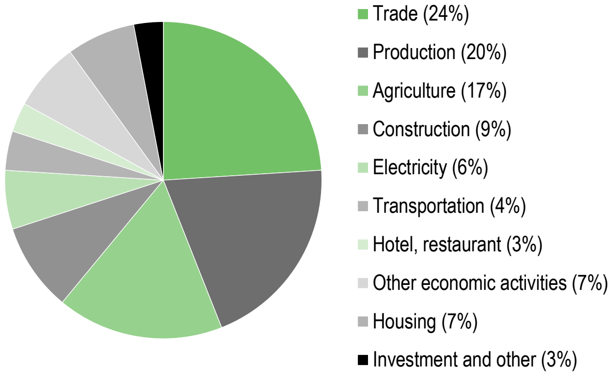
PCB specialises in financing SMEs and private individuals in transition economies, currently in emerging Europe (SEE and EE) and Ecuador (see Exhibit 1), while its German operations are largely focused on providing services to the group such as efficient payment, liquidity and support functions. PCB's focus is on impact-oriented financing, which supports sustainable development, employment and social prosperity. Its long-term mission is to contribute to an inclusive, stable and efficient financial system.

Exhibit 1: PCB's loan book by country at end-2023



Source: PCB data

Exhibit 2: PCB's loan book by sector at end-2023



Source: PCB data

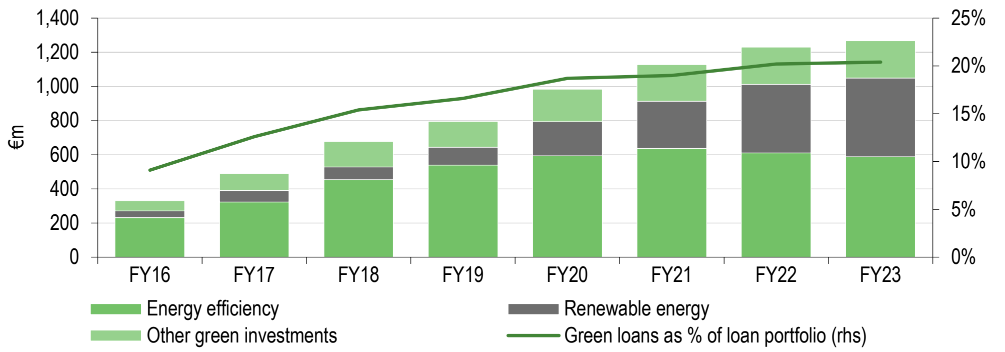
Its 'Hausbank' concept relies on developing long-term relationships as a trusted partner and adviser offering a comprehensive banking experience to clients. It offers simple and transparent products, promotes a savings-oriented culture and puts strong emphasis on prudent credit as well as environmental and social risk management. Moreover, PCB has been actively cooperating with European institutions to foster innovation and has been the largest partner of the last major guarantee programme for SMEs in the Balkans 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).

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. That said, part of PCB's updated strategy includes opening up to third-party suppliers to allow Quipu to focus its development on the core banking system and other central IT applications. The launch of ProCredit Direct in 2017, a digital banking platform primarily for private clients, complemented the existing approach of Hausbank for SMEs 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 has abolished over-the-counter and cash transactions in its branches).

As part of its recently broadened approach to impact orientation, it intends to focus on five SDGs as major KPIs. Three are related to social impact: Gender Equality; Decent Work and Economic Growth (fostered through job creation); as well as Industry, Innovation and Infrastructure (supported by PCB's investment loans). The remaining two SDGs are centred around environmental impact and are supported by PCB's green lending activity and the path to net zero: Affordable and Clean Energy, and Climate Action. PCB's sustainability orientation is illustrated by an FY18–23 CAGR of

13% in its book of green loans, which at end-2023 stood at €1.3bn (ie c 20.4% of its total loan book), which management believes far outperforms local banking sectors. Its green portfolio includes loans to fund energy efficiency projects that reduce energy consumption by at least 20% (these made up 46% of the green loan portfolio at end-FY23), renewable energy (36%) and other green investments (17%), including investments leading to the prevention of air, water and soil pollution, waste management and organic agriculture and production (see Exhibit 3). 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 3: Evolution of PCB's green loan book



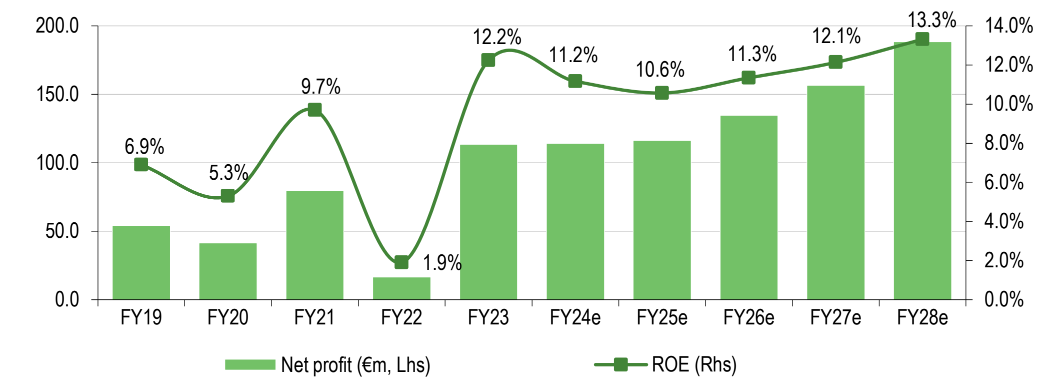
Source: PCB data

We believe 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 include Zeitinger Invest (a strategic shareholder since inception, 18.3% 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 European Bank for Reconstruction and Development (8.7%). The Teachers Insurance and Annuity Association holds an 8.6% stake in the company, and PCB's free float stands at 38.7%.

Updated strategy with a new ROE target of 13–14%

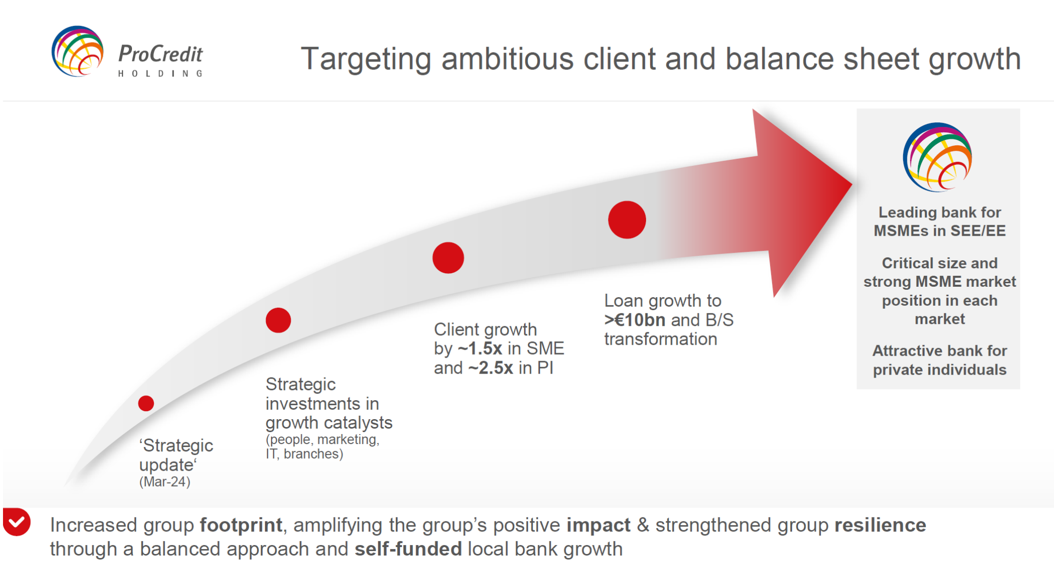
PCB recently made the strategic decision to broaden its footprint and in turn enhance its positive impact on the region. Its updated mid-term ROE target of 13–14% (vs 12% previously) reflects the expected scaling effects from an expanding loan book to more than €10bn (vs €6.2bn at end-2023) and consolidation of margins, which management expects to remain broadly stable in the medium term at the FY23 level of 3.6%. PCB aims to support margins (and offset the impact of the expected decline in base rates) through a more granular deposit base and loan book resulting from the targeted significant medium-term increase in the number of MSMEs and private individual clients of 50% and 150%, respectively. The group grew its MSME client base by 10.8% y-o-y to 72k in FY23. PCB's margins should also benefit from a higher share of deposits in PCB's overall refinancing activities. Management believes the growth in the customer base should also support a gradual rise in PCB's non-interest income. In the short term, PCB's investments to support its new strategy (see below) should keep its ROE below the mid-term target this year and next, though management still expects a good result at c 10–12% in FY24e (we assume 11.2% and 10.6% in FY24 and FY25, respectively, see Exhibit 4).

Exhibit 4: PCB's historical and forecast ROE



Source: PCB data, Edison Investment Research

Exhibit 5: PCB's updated strategy



Source: PCB

PCB's strategy before the recent update

PCB's previous focus was on SMEs with a total loan exposure of €50–500k (small) and €500k–€1.5m (medium), which currently represent 88% of its total loan book. PCB's unique selling point (USP) in this customer segment (which its competitors target mainly with platform banking) has been its comprehensive Hausbank approach (ie serving all customers' banking needs through the tailored approach of PCB's business client advisers (BCAs)). SMEs with total credit exposures of up to €50k were considered non-strategic and were approached by PCB in a non-targeted, opportunistic way. Therefore, they represent c 2% of PCB's loan book at present. PCB also served private individuals, but this was limited to business owners, as well as middle-income and high earners. The group's retail offer mostly included mortgage loans, which represented less than 10% of PCB's total loan book.

Greater emphasis on smaller SMEs, micro and private clients

Following the strategic update, PCB positions itself as a universal bank for MSMEs and private individual clients. The group will put emphasis on the lower end of the market – smaller SMEs (now defined as total loan exposures of between €100k and €750k) – micro-enterprises (loan exposure below €100k) and private individuals, as lending to these client groups is higher margin, more capital-efficient (see below) and offers greater room for growth. Smaller enterprises are more likely to fully embrace PCB's Hausbank approach, therefore being more loyal and providing greater cross- and up-sell opportunities. PCB aims to support growth in this client segment through, among others, simplifying the credit analysis and monitoring process.

However, the above should be considered an adjustment to its earlier approach rather than a complete reshaping of its strategy. While the share in total loan book of medium-sized clients (with loan exposures above €750k) will decline, according to PCB's management, it will remain an important driver of loan book growth (with a targeted increase of at least 50% in the medium term, accounting for c 40% of total loan book growth). We understand that, together with the small SME loan book (which PCB wants to expand by at least 50–100%), it should account for about two-thirds of the targeted mid-term loan book growth. PCB's growth in its core SME segment should be supported by its solid position in most of its local markets. While PCB is a relatively small player when considering the entire banking sector in the region, it is normally among the top three lenders in the SME segment (with some exceptions, such as in Kosovo, where it is the top business lender, and Romania, where it is outside of the top five players, according to PCB).

Opening up to a wider group of private clients

PCB will assume a less restrictive approach to retail clients (which it had previously introduced alongside the direct banking roll-out) and strives to be a universal bank for this client group, offering the full set of services, including loans (most notably mortgage and green loans), non-purpose loans (credit cards/consumer loans, at a single-digit interest rate) and savings plans. It aims to grow its retail loan book by 100–150% in the medium term, which should expand its share in the total loan book from less than 10% at end-2023 to c 15% and account for c 25% of the total mid-term loan book growth, according to our calculations.

That said, the primary objective of PCB's revised strategy towards private individuals is to facilitate a granular, sticky deposit base (to improve its group deposit-to-loan ratio and NIM) rather than to boost its lending margins. It will retain its responsible approach to lending, making sure that clients have good headroom in terms of their capacity to service the debt, with the focus on minimising the default rate rather than solely on maximising profits.

PCB laid the foundations for achieving its ambitions in the retail segment by attracting significant retail deposits in 2022 and 2023 of €1.7bn, with €1bn in FY23 alone (around 50% of which came from retail customers). Based on our discussion with the management, we understand that the main success factors behind the retail deposit growth were PCB's position as a trusted, sustainability-oriented bank, reinforced by its marketing activities, including local events. PCB wants to continue to be appealing to retail clients via its impact story and community activities, as well as through its green lending offer (which now accounts for c 10–15% of the PI loan book, with management expecting a further increase). Moreover, it wants to leverage its strong ties to the SME sector to drive its PI business (approaching SME employees and customers). We note that a factor that could limit PCB's ambitions in the PI segment is its low market share in total customer deposits (c 1% for all banks except for Kosovo), which suggests that growth may require continued extensive marketing activities.

Revisiting its approach to microloans

PCB targets strong growth in the micro-enterprise group, which it now defines as clients with total exposure of up to €100k. These are often small offices (eg lawyers, doctors), small shops and self-employed people who are willing to be serviced entirely via a direct banking approach. Some can graduate to the core SME segment at a later stage. Based on the recent capital markets day presentation, we understand that PCB aims to grow its microloan portfolio by up to 300% in the medium term and expand the microloan share in its total loan book from the current 2% to c 5%

(which we estimate would represent c 10% of the total loan book growth targeted in the medium term). We note that PCB was more active in microloans several years ago, but its activities in this segment were downsized due to the introduction of the direct banking approach (including the associated digitalisation of front-office activities and abandoning of cash transactions in branches) which resulted in the departure of clients who were not ready to embrace full digitalisation. As PCB's management realised that there is a significant addressable market for its direct banking services for micro clients (who also meet the bank's requirements of relatively high levels of formalisation), it now plans to expand its footprint in this direction. This includes lending, but also payment services (including the use of point-of-sale (POS) terminals and e-commerce solutions), and these clients should also bring significant deposits with them. PCB's management believes the stronger emphasis on micro-enterprises should also translate into a greater sustainability impact of its operations.

Planning to leverage ProCredit Direct to gain market share

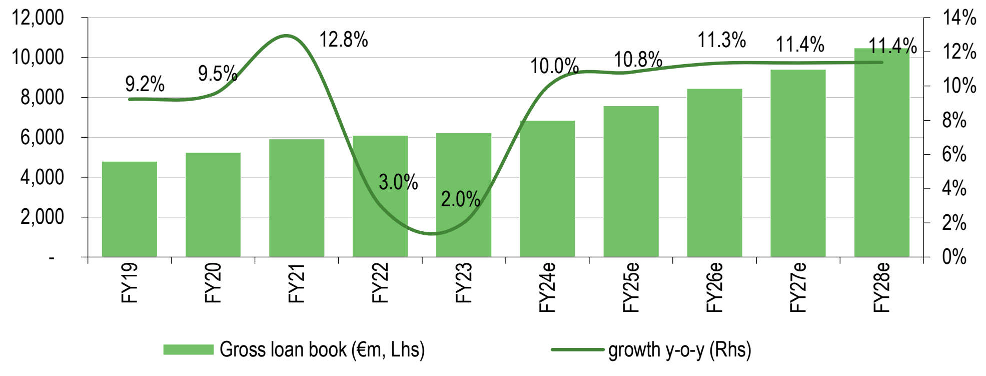
PCB intends to appeal to micro-enterprise and private individual clients with its direct banking approach, and management considers quality, functionality and customer service as its main USPs in the PI segment. It has already deployed automated loan origination, contract signing and loan monitoring processes. It aims to roll out a solution to integrate automated loan origination with automatic lending decisions based on a scorecard for exposures up to €100k in H124. This will be coupled with providing greater flexibility in terms of credit decisions to the local banks. Starting in April (until the end of year), it will roll out digital client onboarding across the banks (though some have already implemented this in previous years). PCB's strategy in the micro-enterprise and PI segment will therefore be supported by the abovementioned ProCredit Direct platform introduced in 2017. PCB's management highlighted that ProCredit Direct covers a natively integrated and scalable technology infrastructure, secured and intuitive front-end channels, and highly automated backend.

Seeking to grow its loan book to over €10bn

As part of its new strategy, the company targets a loan book of more than €10bn in the medium term (ie a more than 60% increase vs the c €6.2bn end-2023). If we assume that PCB aims to reach this target in five years (ie the upper end of the usual three- to five-year horizon PCB historically referred to as medium term), this would imply an average annual loan book growth of more than 10% (including c 10% FX-adjusted growth guided in FY24). PCB's growth in the period 2018–2021 was around 10–13% pa, but slowed down in 2022 and 2023, affected by loan book reduction in Ukraine following the outbreak of the war, a weaker macroeconomic environment (especially in Ecuador), as well as management's emphasis on margin optimisation and increasing the deposit-to-loan ratio at the expense of growth. The loan portfolio of ProCredit Bank Ukraine was reduced by €174m and €85m and in FY22 and FY23, respectively (ie 3.0% and 1.4% of end-2021 and end-2022 loan book at group level, respectively), mostly due to currency devaluation, steady repayments and write-offs of loans provided to entities located in warzone or regions under occupation. Growth excluding Ukraine was 6.9% and 3.7% in FY22 and FY23, respectively. Interestingly, over 50% of the FY23 growth came from small-capacity renewable energy loans (PCB's overall renewable energy portfolio grew by 14.9% y-o-y).

We consider a 10%+ prospective annual increase in group loan book as achievable and assume 10.0% for FY24 and a FY25–28 CAGR of 11.2% (vs previous assumptions of 5.0% and 7.5%, respectively), see Exhibit 6. This is because of 1) still low penetration of banking services across the region (with loan book to GDP at 0.5x in SEE/EE vs c 0.8x in Central and Eastern Europe and 1.4x in Western Europe), including SMEs, which are often underserved; 2) broadened focus in terms of customer groups coupled with selective branch expansion and the roll-out of new services (eg POS terminals, e-commerce platforms); 3) PCB's expectations of no major loan book reductions in Ukraine and Ecuador in the near term; and 4) continued strong expansion in deposit base.

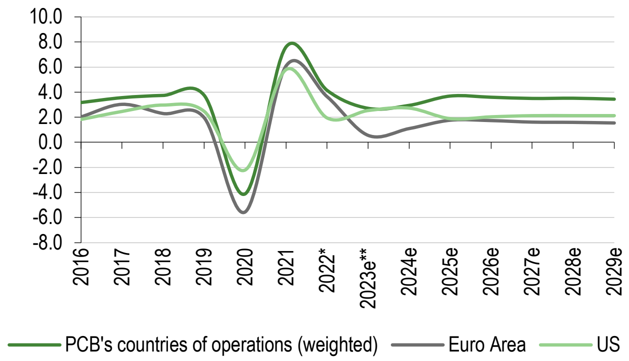
Exhibit 6: PCB's historical and forecast loan book growth



Source: PCB data, Edison Investment Research

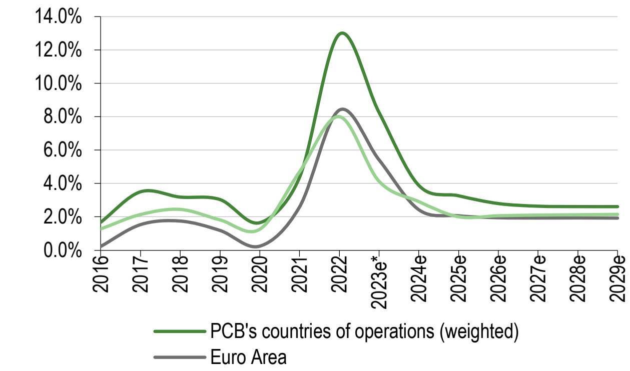
PCB's growth ambitions should be supported by a favourable mid-term economic outlook in the SEE/EE region. According to recently released IMF forecasts, GDP growth across PCB's countries of operations should stand at c 2.5–4.0% in 2024 (except for Georgia at 5.7%) and accelerate to c 3.0–5.0% in 2025 and beyond (see Exhibit 7). Meanwhile, the IMF expects inflation across the region to moderate to sub-5% levels by 2025 (see Exhibit 8).

Exhibit 7: Average real GDP growth of PCB's countries of operations compared to the euro area and the US



Source: Edison Investment Research based on data from the IMF World Economic Outlook April 2024 database. Note: Weighted average based on the share of PCB's loan book in the relevant year (2023 share of 2024–29e). *Excluding Ukraine. **Based on country-level estimates of the IMF except for Bulgaria, North Macedonia and Georgia, which are actuals.

Exhibit 8: Average inflation rate of PCB's countries of operations versus the euro area and the US



Source: Edison Investment Research based on data from the IMF World Economic Outlook April 2024 database. Note: Weighted average based on the share of PCB's loan book in the relevant year (2023 share of 2024–29e). *Actuals except for Kosovo and Albania, which are IMF estimates.

PCB aims to keep its NIM stable at FY23 levels

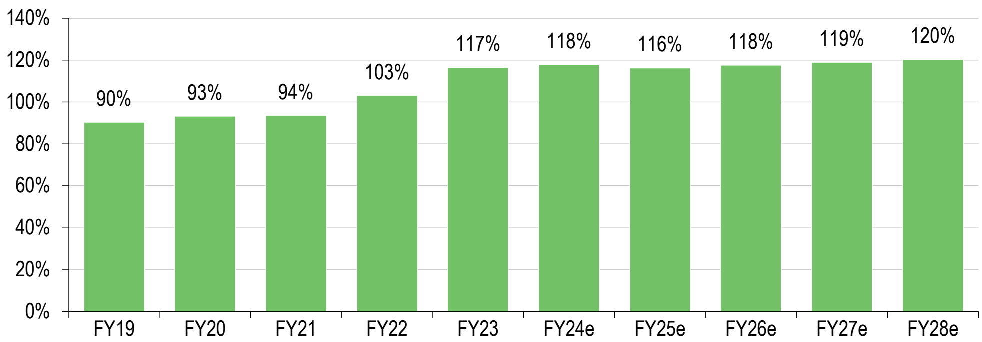
PCB's NIM should be supported by: 1) a greater granularity on both the loans and deposits side (ie higher number of customers with a lower share in total volume); 2) a shift to higher-margin customer groups; and 3) an improved share of deposits in refinancing compared to a few years ago. Management highlighted that the weighted average interest rate (WAIR) on its loan book in FY23 stood at 6.9% for medium-sized clients, 8.0% for small clients, 9.2% for micro clients and 5.1% for private individuals. The PI WAIR was comparatively low due to: 1) a higher share of mortgage loans; and 2) a high concentration of the loan book in countries with low interest rates

(Kosovo, where the euro is the official currency, and Bulgaria, which is a member of the European Exchange Rate Mechanism). Management highlighted that the PI WAIR should normally be somewhere between the rate for small and micro-enterprise clients.

Based on the above, we estimate that, all being equal, the targeted shift in PCB's loan book composition could add c 20bp to PCB's NIM at group level. We believe that this should be enough to offset the NIM decline to c 3.4–3.5% by FY26/FY27 which we previously assumed in our forecasts. Therefore, we now assume a broadly stable NIM versus end-2023 in the medium term (and a decline from the 3.8–3.9% PCB reported in Q3/Q423) throughout our forecast horizon, in line with management guidance. That said, we assume a slight dip in FY25e when base rates may be lower than currently while PCB's loan book shift may have not fully materialised yet.

Management targets a deposit-to-loan ratio of 120% in all its entities, compared to 116.5% on average across the group in FY23 (visibly up from 103.0% in FY22). The improving ratio should be supported by the shift to smaller enterprise and PI clients, which normally exhibit a higher deposit-to-loan ratio (c 85% for small, c 200% for micro and c 500% for PI vs c 50% for medium-sized enterprise clients). Based on PCB's loan book target, the targeted deposit-to-loan ratio implies more than €12bn of customer deposits in the medium term (ie an increase of more than €4.7bn vs end-2023). This ambition looks achievable on a five-year horizon (at least at the lower end) given PCB's recent growth in the deposit base (see above), though it may require extensive marketing efforts. PCB targets a 50% share of PI clients in its deposit base in the medium term, which would require an even greater contribution to growth from this customer group than recently. That said, we note that the turn in the interest rate cycle should provide some headwinds, as it could result in a lower relative attractiveness of bank deposits versus other investment opportunities. While PCB plans to offset this through the high granularity of its deposit base (limiting deposit outflows), we are cautious in our forecasts (also given the drag from the Ecuadorian bank) and assume PCB will reach a deposit-to-loan ratio of c 120% at group level by FY28 (see Exhibit 9).

Exhibit 9: PCB's historical and forecast deposit-to-loan ratio

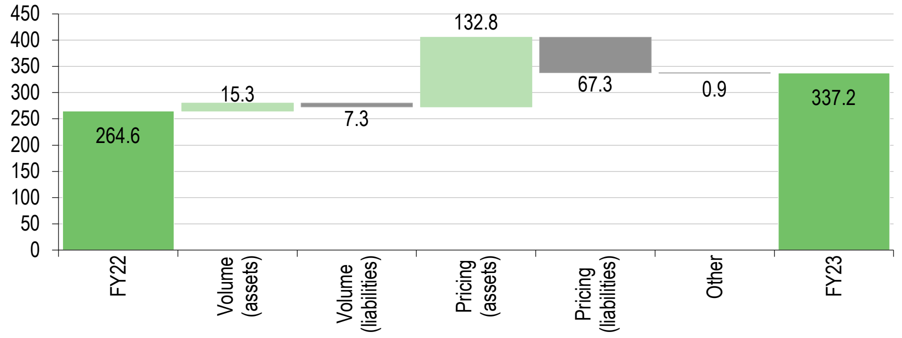


Source: PCB data, Edison Investment Research

PCB has recently prioritised offering term deposits for short tenures, which should make it easier to reprice them to the downside when the interest rate cycle turns. So far, upward repricing on the assets side continued to outstrip the repricing of deposits (see Exhibit 10). Moreover, cost of customer deposits grew by 0.6–0.7pp in FY23, below the repricing of wholesale funds.

While medium-sized enterprises normally have a higher fee income potential for PCB, they embrace its Hausbank concept to a lesser extent, which means that PCB is unable to capture part of the income opportunity. Therefore, the negative impact of PCB's reduced emphasis on medium-sized enterprises on fee income should be offset by the overall growth in client base, as well as greater income from services such as POS terminals and trade finance.

Exhibit 10: PCB's net interest income waterfall FY23 (€m)

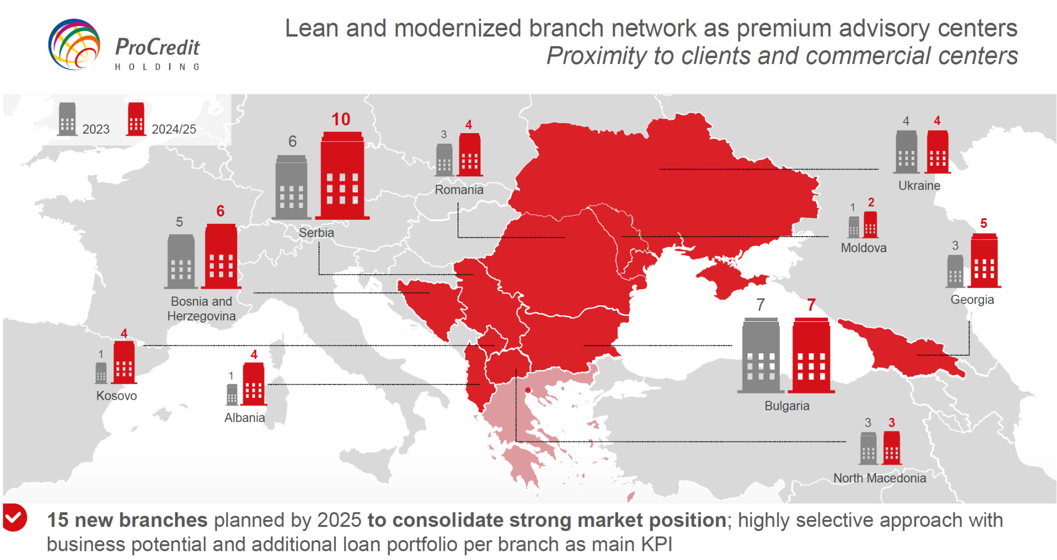


Source: PCB data

CIR to rise temporarily amid new strategy execution

PCB's management plans to make sizeable investments in 2024 and 2025 into IT, marketing, headcount expansion (part of which was already incurred in FY23), as well as the selective opening of new branches in tier-2 economic hubs to facilitate its new ambitions, resulting in a CIR guidance of c 63% for FY24 (vs 59.9% reported in FY23). PCB intends to increase its headcount by 25%, partly due to the reconstruction of its retail teams to facilitate the transition to a universal bank for PI clients. Meanwhile, PCB is working on revising and streamlining its processes to free up BCAs' capacity to serve more core SME clients. At the lower end of its client base, PCB plans to further digitalise its operations. PCB's branch expansion plan should not be considered a return to its previous approach a decade ago, as it now aims to expand its branch network only moderately by 15 branches to around 50, compared with 645 branches in FY13 (see Exhibit 11).

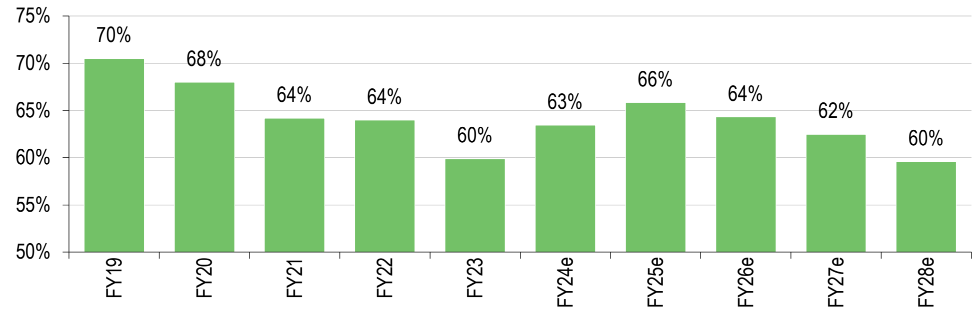
Exhibit 11: PCB's branch expansion plan



Source: PCB. Note: Shows the group's branch network in SEE and EE countries, excluding service points.

Management expects this to translate into €10m of additional network costs per year from increased office rent and depreciation. Moreover, it assumes a €12m (or 20%) rise in IT costs and a €5m (or 50%) increase in marketing expenses. In the medium term, PCB expects to realise economies of scale to reach a CIR of c 57% (excluding one-offs), unchanged versus the previous mid-term target. We conservatively assume a FY24e and FY25e CIR of 63% and 66%, respectively (due to, among others, the competitive local labour markets), followed by a gradual improvement to 60% in FY28 (see Exhibit 12). This compares with our earlier forecast of c 63% in both FY24e and FY25e, followed by c 60% by FY27e.

Exhibit 12: PCB's historical and forecast cost-to-income ratio

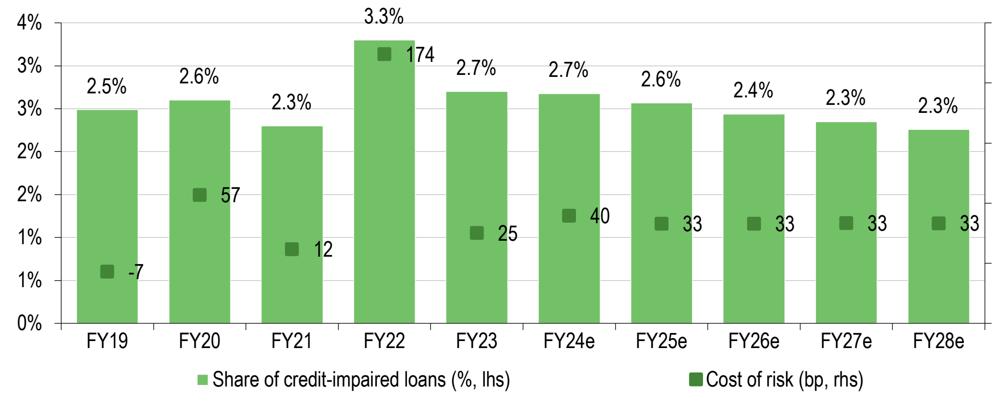


Source: PCB data, Edison Investment Research

New cost of risk guidance reflects business shift

PCB's management guides to FY24e cost of risk of up to 40bp, though it considers the upper end as rather high, especially given that the €22m management overlays booked in FY23 provide an additional safety margin. It has also slightly increased its mid-term, over-the-cycle cost of risk guidance to 30–35bp (vs 25–30bp previously and 25bp reported in FY23) on the back of more ambitious growth plans, as well as the somewhat higher risk profile of the targeted mix of client segments. That said, its Hausbank approach should allow it to react in advance to any signs of client distress, translating into still limited cost of risk. In this context, it is worth noting that PCB has a strong track record of credit risk management, with the average annualised cost of risk in the period 2017–2022 at 17bp, which includes both provisions related to COVID-19 and the war in Ukraine. We now assume a cost of risk at the upper end of PCB's FY24 guidance, that is 40bp in FY24 and c 33bp on average in the subsequent years.

Exhibit 13: PCB's historical and forecast cost of risk

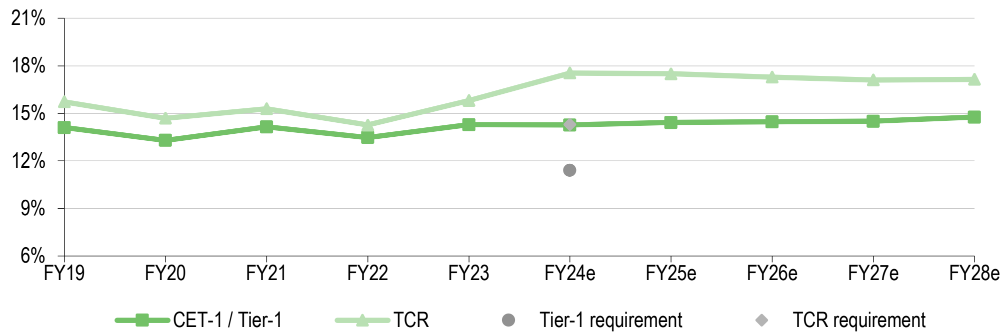


Source: PCB data, Edison Investment Research

Retaining a robust capital base

At end-2023, PCB's CET-1 ratio stood at 14.3% (well above the regulatory requirement of 9.3%) and the total capital ratio stood at 15.8% (vs regulatory requirement of 14.3%). Given the above and assuming PCB can reach a 120% deposit-to-loan ratio, it should be able to self-fund the targeted growth (ie without the need to raise equity). We note that PCB has been implementing several risk weighted asset (RWA) density improvement measures, which allowed it to reduce the RWA as a percentage of assets to 64% at end-2023 from 69% at end-2022. PCB's mid-term target is to reduce this further below 60%, which should also be supported by the shift in client mix. Medium-sized clients are characterised by risk weights of c 75–85%, while small and micro clients benefit from the application of both the SME and the retail factor, resulting in a risk weight of 57% (retail has a fixed 75% risk weight). PCB's RWA efficiency is further supported by guarantees (especially in the medium and small segment). We also note that PCB's total capital ratio (TCR) will be supported by its recently completed issue of €125m green tier-2 bonds.

Exhibit 14: PCB's historical and forecast CET-1/tier-1 and total capital ratio



Source: PCB data, Edison Investment Research

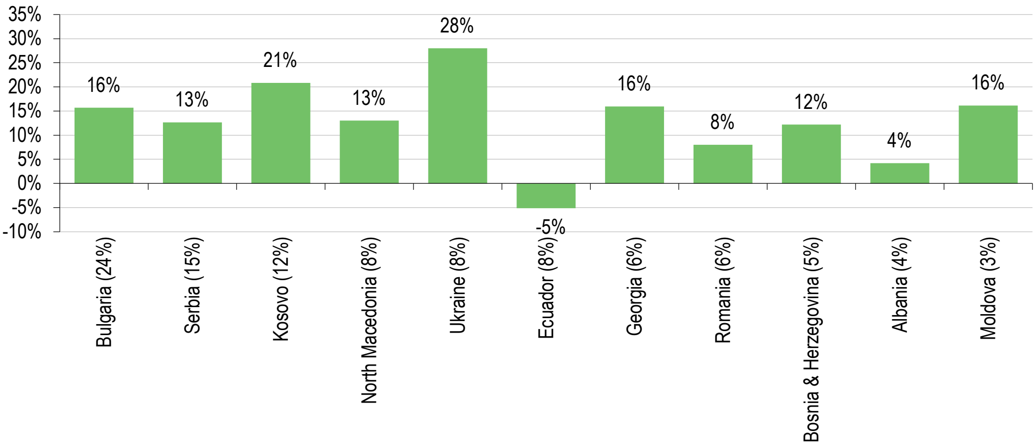
PCB's strategy varies by local bank

We note that PCB's local banks are at various stages of their development. Its banks in Kosovo and Bulgaria are the most mature, with good scale and profitability, and a focus on further consolidating their market position. Management considers PCB's banks in Serbia and North Macedonia as being at an advanced stage, with emphasis on further growth but also optimisation of balance sheet structure to drive profitability. Finally, the banks in Georgia, Romania, Bosnia, Albania and Moldova are considered subscale and therefore PCB intends to significantly invest in the transformation of their balance sheets and on driving scaling effects. According to PCB's management, these banks may exhibit a 'hockey stick' performance, with initial years characterised by investments that should subsequently result in a considerable improvement in performance.

PCB's management considers the bank in Kosovo as the 'blueprint' for other regional banks, given its strong local position as the top SME lender, coupled with its solid position among PI clients as a universal bank (14% market share in PI deposits, 21% of loan book to PI clients), a 123% deposit-to-loan ratio and healthy ROE of 20.8% in FY23. However, we note that Kosovo's market position benefited from a first-mover advantage, as it participated in the establishment of the local banking sector from scratch.

That said, we note that there are further good examples of PCB's ability to drive performance of local banks, such as the recent development of its bank in Bosnia and Herzegovina. The local bank improved its ROE from 3.8% in FY21 to 12.2% in FY23 and raised its deposit-to-loan ratio from 84.0% at end-2021 to 124.4% at end-2023 (it was able to double its non-client base between FY19 and FY23). It now targets a ROE of 13% and an increase in the share of retail deposits to 50% (vs 32% currently) over the medium term.

Exhibit 15: FY23 ROE of PCB's local banks



Source: PCB data; Note: Share in end-2023 loan book indicated in brackets.

Ecuador's macroeconomic and sociopolitical challenges

PCB continues to operate a local bank in Ecuador, which has been facing multiple headwinds from the difficult macroeconomic situation in the country, further amplified by the political and social unrest stemming from gang violence recently. The SME lending rate caps introduced in the country (at c 9.0–9.5%) are currently close to the local refinancing rates, which makes the SME lending business unprofitable for the time being. PCB's Ecuadorian bank plans to pursue a similar strategy to the rest of the group, focusing on improving its deposit-to-loan ratio and moving further into the micro and PI client businesses were lending caps are higher (at c 20%). The shift towards small and micro clients had already partly materialised in FY23, which allowed the bank to increase the average interest rate on the assets side by 1.1pp y-o-y.

ProCredit Bank Ukraine's FY23 results may be hard to sustain

PCB's local bank in Ukraine achieved a very strong profit of €17.7m (implying an ROE of 28%) in FY23 despite €5.5m loss allowances (representing an annual cost of risk of 103bp), which were mostly driven by c €13m of management overlays. Moreover, the results were negatively affected by a one-off tax charge in Q423 of €10m (without which the ROE would be well above 30%). This was supported by a strong NIM of 6.5% in FY23 (vs 4.9% in FY22). However, we note that the National Bank of Ukraine reduced its main policy rate throughout 2023 from 25% to 15% (now at 14.5%). This, together with continued uncertainty with respect to cost of risk given the ongoing war, led PCB's management to assume a high single-digit to low double-digit million-euro profit contribution from Ukraine per annum going forward. PCB's management sees an upside potential of around 1.5pp on its medium-term ROE from a potential materialisation of a bull scenario for Ukraine (ie end of war and reconstruction).

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-2023, arriving at an equity risk premium of 10.8% (previously 11.6%). We have used a risk-free rate of 2.56%, in line with the current euro area yield curve for a 10-year maturity. We have also applied a beta of 0.78x (in line with the average beta for banks in emerging markets as provided by Aswath Damodaran), which is a slight reduction from the 0.80x we used previously. We have retained our long-term growth rate assumption of 2.0%. Although we consider PCB's 13–14% mid-term ROE target achievable and we have reflected the improving profitability outlook in our forecasts, we have conservatively retained our sustainable RoTE assumption of 11%. Our new assumptions imply a P/BV multiple for PCB of 1.00x (see Exhibit 16), versus 0.80x in our previous valuation, with part of the increase attributable to rolling our valuation to the FY24e tangible book value per share.

A regression line based on FY23 P/BV and ROE indicators for PCB's peers implies a P/BV multiple (for PCB's sustainable RoTE of 11%) of 0.79x (see Exhibit 18). As a result, we have assumed a fair value multiple of 0.90x, which is the average of the multiple derived from the CAPM and the regression analysis. This implies a fair value per PCB share of €14.70 (up from €13.00 in our November 2023 update) and implies 56% potential upside to the current price of €9.42. 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.

If we assumed a sustainable RoTE of 13–14% (in line with management's mid-term target), we would arrive at a fair value per PCB's share of €17.20–18.50.

Exhibit 16: PCB's P/BV-ROE valuation

€'000s unless otherwise stated	FY23	FY24e	FY25e	FY26e	FY27e	FY28e
Shareholder's equity	983,789	1,060,154	1,138,312	1,234,216	1,345,920	1,482,054
Intangibles	22,732	22,732	22,732	22,732	22,732	22,732
Tangible equity	**961,057**	**1,037,422**	**1,115,580**	**1,211,484**	**1,323,188**	**1,459,322**
Net attributable profit	113,372	114,156	116,210	134,641	156,584	188,328
RoTE	***12.5%***	***11.4%***	***10.8%***	***11.6%***	***12.4%***	***13.5%***
Tangible equity per share (€)	**16.3**	**17.6**	**18.9**	**20.6**	**22.5**	**24.8**
Tangible equity per share (FY24e, €)	**17.6**					
Sustainable RoTE	11.0%					
Growth rate	2.0%					
Cost of equity	11.0%					
Fair value multiple – CAPM model	1.00x					
Fair value multiple – regression multiple	0.79x					
Fair value multiple – simple average	**0.90x**					
Fair value per share (end-2024, €)	15.77					
Discount factor	*0.93*					
Fair value per share (€)	**14.70**					
Current share price (€)	9.42					
Potential upside/downside	*56%*					

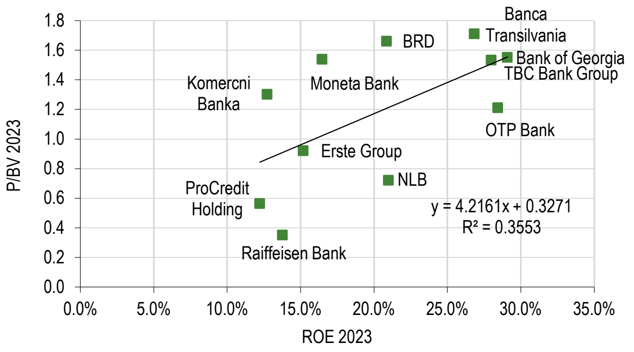
Source: ProCredit, Edison Investment Research

Exhibit 17: PCB's valuation sensitivity analysis (€/share)

		Sustainable RoTE						
		8.0%	**9.0%**	**10.0%**	**11.0%**	**12.0%**	**13.0%**	**14.0%**
Cost of equity	9.5%	12.02	13.46	14.90	16.34	17.78	19.23	20.67
	10.0%	11.61	12.98	14.36	15.73	17.10	18.47	19.85
	10.5%	11.25	12.56	13.87	15.18	16.50	17.81	19.12
	11.0%	10.93	12.19	13.44	**14.70**	15.96	17.22	18.48
	11.5%	10.64	11.85	13.06	14.27	15.48	16.69	17.90
	12.0%	10.38	11.55	12.71	13.88	15.05	16.21	17.38
	12.5%	10.15	11.27	12.40	13.53	14.66	15.78	16.91

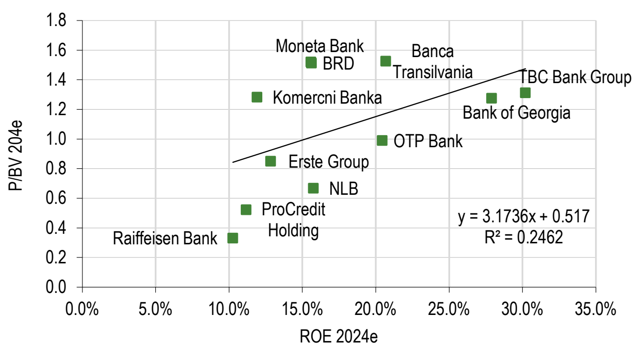
Source: Edison Investment Research

Exhibit 18: P/BV versus ROE – PCB's peers (2023)



Source: LSEG as at 26 April 2024.

Exhibit 19: P/BV versus ROE – PCB's peers (2024e)



Source: LSEG consensus at 26 April 2024 except for ProCredit Holding (Edison Investment research estimates).

Sensitivities

Strategy execution risk: Although PCB's latest strategic update does not represent a complete change of strategy, it still poses certain execution risks, mostly around its expansion into retail, the introduction of automated credit decisions and monitoring, the expansion of its branch network, as well as the ability to reach the targeted deposit-to-loan ratio, among others.

Macroeconomic risk remains higher in PCB's countries of operations compared to Western Europe and Central and Eastern European countries given the earlier stage of economic development and several challenges or risks these economies face. These include: 1) higher share of foreign currency-denominated loans in the banking sector in several countries; 2) susceptibility to global supply chain disruptions; 3) high reliance on remittances (eg Kosovo, Albania, Moldova) and high tourism contribution to GDP (eg Georgia, Albania); and 4) Ecuador's high sensitivity to oil prices.

War in Ukraine: in a worst-case scenario for PCB, we assume a default of ProCredit Bank Ukraine. 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. This would imply a fair value of PCB at €13.15 per share.

Political risk is elevated in several SEE/EE countries, as illustrated by military conflicts (including Russia's current war of aggression against Ukraine), territorial disputes (Kosovo-Serbia) and internal political deadlocks (eg North Macedonia in 2015–17). As global populism has intensified in recent years, the Western Balkans face the potential risk of conflicts between parties appealing to major ethnic groups. Moreover, the region is one of the playgrounds for political competition between the West and Russia. We also note the difficult political and social situation in Ecuador, which represents a significant risk to the performance of PCB's local bank. Having said that, we note that two countries where PCB operates – Bulgaria and Romania – are EU members, while Albania, Bosnia and Herzegovina, Moldova, North Macedonia, Georgia and Serbia are EU member candidates. Several countries are also NATO members (Albania, Bulgaria, North Macedonia and Romania). Finally, we note that PCB has extensive experience in operating in these countries and navigating through times of political and military unrest.

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 subsequently adjusted downwards.

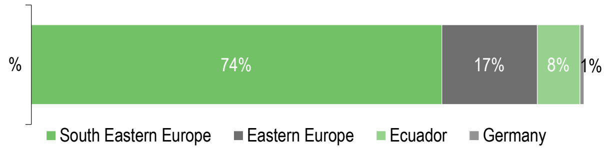
Weather anomalies and natural disasters pose a risk for PCB's significant exposure to agriculture loans (17% at end-2023).

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. Moreover, these fintechs often address the nonbankable part of the market, which PCB is not targeting.

Exhibit 20: Financial summary

Year ending 31 December, €000s	2019	2020	2021	2022	2023	2024e	2025e	2026e	2027e	2028e
Income statement										
Net interest income	194,533	201,561	222,021	264,634	337,224	365,945	391,639	432,587	477,867	529,361
Net fee and commission income	51,972	47,380	50,855	54,731	57,525	60,300	65,164	69,472	74,165	79,279
Operating income	249,275	252,114	281,881	339,848	412,506	442,896	475,119	522,401	574,626	633,688
Operating expenses	175,737	171,430	180,859	217,428	246,979	281,034	312,782	335,939	358,942	377,394
Loss allowances	(3,327)	28,600	6,490	104,573	15,513	25,889	23,798	26,497	29,765	33,102
PBT	**76,865**	**52,084**	**94,532**	**17,847**	**150,015**	**135,973**	**138,538**	**159,965**	**185,918**	**223,191**
Net profit after tax	**54,304**	**41,395**	**79,641**	**16,497**	**113,372**	**114,156**	**116,210**	**134,641**	**156,584**	**188,328**
Reported EPS (€)	**0.89**	**0.70**	**1.35**	**0.28**	**1.92**	**1.94**	**1.97**	**2.29**	**2.66**	**3.20**
DPS (€)	0.00	0.53	0.00	0.00	0.64	0.65	0.66	0.76	0.89	1.07
Balance sheet										
Cash and balances at central banks	1,081,723	1,405,349	1,545,523	1,939,681	2,347,617	2,668,376	2,821,521	3,123,343	3,529,375	3,970,793
Loans and advances to banks	320,737	236,519	252,649	280,453	372,141	372,141	372,141	372,141	372,141	372,141
Investment securities	378,281	336,476	410,400	480,168	750,542	750,542	750,542	750,542	750,542	750,542
Loans and advances to customers	4,690,961	5,131,582	5,792,966	5,892,796	6,029,715	6,643,442	7,385,232	8,243,839	9,189,951	10,246,999
Property, plant and equipment and investment properties	138,407	140,744	137,536	133,703	137,423	137,423	137,423	137,423	137,423	137,423
Intangible assets	20,345	19,316	18,411	17,993	22,732	22,732	22,732	22,732	22,732	22,732
Other assets	67,106	59,315	58,416	81,330	88,798	93,444	88,798	93,444	88,798	93,444
Total assets	**6,697,560**	**7,329,301**	**8,215,901**	**8,826,124**	**9,748,968**	**10,688,100**	**11,578,389**	**12,743,464**	**14,090,962**	**15,594,074**
Liabilities to banks	1,079,271	1,235,763	1,313,666	1,318,647	1,127,680	1,048,742	1,111,667	1,067,200	1,045,856	993,563
Liabilities to customers	4,333,436	4,898,897	5,542,251	6,289,511	7,254,236	8,070,940	8,820,147	9,933,784	11,190,923	12,610,193
Debt securities	343,727	266,858	353,221	191,988	147,088	147,088	147,088	147,088	147,088	147,088
Subordinated debt	87,198	84,974	87,390	93,597	139,269	264,269	264,269	264,269	264,269	264,269
Other liabilities	50,436	63,080	63,059	62,946	96,906	96,906	96,906	96,906	96,906	96,906
Total liabilities	**5,894,068**	**6,549,573**	**7,359,587**	**7,956,689**	**8,765,179**	**9,627,946**	**10,440,077**	**11,509,247**	**12,745,042**	**14,112,020**
Total shareholders' equity	**803,492**	**779,728**	**856,314**	**869,435**	**983,789**	**1,060,154**	**1,138,312**	**1,234,216**	**1,345,920**	**1,482,054**
BVPS	13.5	13.2	14.5	14.8	16.7	18.0	19.3	21.0	22.9	25.2
TNAV per share	13.1	12.9	14.2	14.5	16.3	17.6	18.9	20.6	22.5	24.8
Ratios										
NIM	3.10%	2.90%	2.90%	3.11%	3.63%	3.58%	3.52%	3.56%	3.56%	3.57%
Costs/Income	70.5%	68.0%	64.2%	64.0%	59.9%	63.5%	65.8%	64.3%	62.5%	59.6%
ROE	6.9%	5.3%	9.7%	1.9%	12.2%	11.2%	10.6%	11.3%	12.1%	13.3%
CET1 Ratio	14.1%	13.3%	14.1%	13.5%	14.3%	14.3%	14.4%	14.5%	14.5%	14.8%
Tier 1 ratio	14.1%	13.3%	14.1%	13.5%	14.3%	14.3%	14.4%	14.5%	14.5%	14.8%
Capital adequacy ratio	15.7%	14.7%	15.3%	14.3%	15.8%	17.6%	17.5%	17.3%	17.1%	17.1%
Payout ratio (%)	33.3%*	33.3%*	0.0%**	0.0%**	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%
Customer loans/total assets	71.6%	71.7%	72.1%	69.1%	63.9%	64.1%	65.5%	66.3%	66.8%	67.2%
Deposits/loans	90.3%	93.2%	93.5%	103.0%	116.5%	117.9%	116.3%	117.6%	119.0%	120.4%

Source: PCB data, Edison Investment Research. Note: *In 2021, PCB distributed one-third of the accumulated profits from 2019 and 2020. **In light of the war in Ukraine and the risk of a broader escalation of the conflict, which could have adversely affected PCB's business in the entire region, no dividends were paid out in 2022 and 2023, contrary to PCB's dividend policy of distributing one-third of consolidated profits.

Contact details	Gross 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: Christoph Beeck
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 communications and corporate office.	Christoph Beeck is responsible for human resources, fraud prevention and compliance, anti-money laundering, internal audit, as well as administration and translation.
Board member: Eriola Bibolii	**Board member: George Chatzis**
Eriola Bibolii joint ProCredit Holding in 2023 and she is the group's Chief Risk Officer. She previously spent more than 20 years at ProCredit Bank Kosovo, where she was member of the management board from 2007 to 2023	George Chatzis has more than 20 years of experience in the banking sector and before joining ProCredit Holding in April 2024, he was chief risk officer at Rabobank Frankfurt and International Direct Bank Europe and head of HR at Rabobank Frankfurt.
Board member: Christian Dagrosa	**Board member: Dr Gian Marco Felice**
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 group's CFO responsible for accounting and taxes, supervisory reporting and capital planning, group funding and treasury, controlling, reporting and data management, investor relations, as well as data systems projects.	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 group environmental management and impact reporting, IT, as well as business support and development.

Principal shareholders	(%)
Zeitinger Invest	18.3
KfW	13.2
DOEN Participaties	12.5
European Bank for Reconstruction and Development	8.7
TIAA	8.6
Free float	38.7

London | New York | Frankfurt
20 Red Lion Street
London, WC1R 4PS
United Kingdom