Title: Wema Bank Half-Year 2017 Investor & Analyst Conference Call

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Speakers: Ademola Adebise and Tunde Mabawonku

Introduction and Presentation

Operator

Hello, and welcome to Wema Bank's Half-Year 2017 Investor and Analyst Conference Call. Throughout the call, all participants will be in a listen-only mode, and afterwards there will be a question and answer session. Just to remind you, this conference call is being recorded.

Today, I am pleased to present Mr Ademola Adebise, Deputy Managing Director for Wema Bank. Please go ahead with your meeting.

Ademola Adebise

Good afternoon, ladies and gentlemen. My name is Demola Adebise. I'm the Deputy Managing Director of Wema Bank. I welcome you to our Half-Year Investor Conference Call.

With me on this call, I have my colleagues. I have Mr Moruf Oseni. He is the Executive Director in charge retail banking. He has responsibilities for the digital bank – of the bank. I also have Mr Tunde Mabawonku, who is the Chief Finance Officer for the bank. Also with me in this call is Mrs Funmilayo Falola. She's our Head of Brand and Marketing.

This presentation is going to be in three segments. If you join me on slide 3 of the presentation, the three segments – the first segment – I will be handling the first segment, Tunde will be handling the second segment, while I will close up with the third segments on the outlook and the strategy.

Let's go to slide 5. The first half of 2017, we've seen quite a number of activities at the global scene that have affected economies. For example, the Brexit negotiation, the increase in the Fed rates in the US. This has had a particular impact on funds flow, especially to emerging markets.

On the domestic scene, we've seen improvements in the economy based on the PMI numbers that have just been released. In terms of oil prices, oil prices have been a bit volatile, though below – about $52 on average in 2017. We believe that this may – we have concerns on this considering that fact that the shale oil production is increased, and also the fact that there are discussions on OPEC oil costs. This has a direct impact on the Nigerian economy as revenues are tied to this.

The Central Bank also has – they are – we can see positive results in terms of foreign exchange. There has been the introduction of a number of markets, the latest market being the NAFEX market. We can see some convergence between the NAFEX market and the parallel market. The liquidity in the FX market is improving and this is having some positive impact on the economy.

Inflation rate though it's trending downwards, interest rates are still on the high side. This is largely based on the fact that government treasury bills are still priced at very high rates.

Slide 6. The Central Bank has maintained a steady monetary policy this year, and we can see that in the CRR rates and the MPR rates that have been maintained all through. We could see that the FX market is – there are some improvements in the FX market. All this is geared towards improving the FDIs and the FDI inflows into the economy.

For Wema Bank, Slide 7, for the first half of the year, the major highlights of our performance is around the launch of our digital bank, ALAT. This has impacted significantly on the perception of the bank, and also on the bottom line. This is in line with our retail strategy, to deepen our retail strategy. We can begin to see the numbers are looking up.

In terms of our credit rating, the Fitch rating, in the international global rating agency, has maintained our rating as stable. In terms of service delivery, we've also had improvements in our service delivery ratings. The KPMG Service Ranking has moved Wema Bank from the 13th position last year to 8th this year, as we speak, in the retail space.

In terms of our branch expansion and refurbishments, we'll continue to improve on this. We have one branch that has been opened this year. We expect that two more branches will be opened before the end of the year.

In term of branch renovation, we also continue with this. Seven new branches have – are under renovation, as we speak. Again, as I said, we have alternate channels, we continue to improve on this and the numbers are improving.

In terms of our strategic objectives, our priorities for the year, we came up with the three E strategy at the beginning of the year: Excellence, Expertise and Efficiency.

If we look at the goals, basically, we are improving. We on-boarded additional 120,000 retail accounts between January and June. Despite the fact customer deposits have dropped by about 20 billion, we improved on savings deposits by about 5%. This is largely due to the introduction of the digital bank. I've talked about the service ratings, improving from 13th to 8th position.

In terms of deployment of channels, we continue to also improve on that. In terms of new cards issued to customers, well, this grew by about 55%. On the USSD platform, which is another channel on which we reach our customers, grew by about 73%. And also, in terms of acquiring more merchants on the mCASH platform, which is a platform, a payment platform, introduced by NIBSS. Again, we are ramping up the numbers. Agency banking is also in pilot phase, and this is – again, all these are tied to our retail strategy.

Let's move to slide 9. On slide 9, we have a detailed report on ALAT, which is our digital bank. The digital bank was launched in May 2017. And up to June 30th, over 26,000 accounts have been opened with a balance of about ₦251 million. As we speak today, we have over 32,000 accounts opened as of yesterday, and with a balance of ₦334 million.

One of the beauties of ALAT is that the value composition is very strong. We talked about convenience, reliability and simplicity. It also allows you to save in a convenient and disciplined manner. To date, we have about over 2,900 savings goals created on the system with over 100 million. And these numbers are growing every day.

We've also had a number of updates on ALAT. We've introduced biometrics. We've introduced viral marketing. We call it 'Refer a Friend'. And, of course, we've made ALAT lighter in the sense that you only need your signature and your selfie to be able to have an account.

Again, as we have in the digital space, a number of collaborations are taking place. We're collaborating with a number of players in e-commerce, the film industry, the entertainment industry and number of players and more engagements are coming up. Basically, the essence of this is to collaborate to improve on customer base and to improve on the lifestyle of our customers.

Again, in terms of upcoming features, a number of upcoming features are coming to change the landscape. We have the QR payments. This is coming up very shortly. Also, recurring bill payments where you can set up your recurring bills for utilities. One other feature that will be very mind blowing is the virtual card for foreign payments. Today, most banks, their cards are not enabled for foreign payments. But we're going to come up with a virtual card that will be enabled for foreign payments. And this is going to be the first of its kind in Nigeria. We're also going to be working on the cardless withdrawal. You'd be able to – you do not need to have your ALAT card or any of your cards with you. You can make your withdrawals on any ATM in Nigeria.

The next slide, slide 10, shows us some of the pictures from some of the major events that we've had this year. The ALAT launch, the opening of our Kaduna branch and the number of campus storms that we've had for the launch of ALAT – after the launch of ALAT. In terms of the bank, we had stable and consistent performance all through.

At this point, I'll just hand over to Tunde Mabawonku, my colleague, who will shed some more light on the numbers and I will come back to close the presentation. Thank you.

Tunde Mabawonku

Okay. Thank you very much, sir.

Good afternoon. My name is Tunde Mabawonku, the Chief Financial Officer of Wema Bank Plc. What I will do in the next few minutes is to roll you through the financial numbers, but mostly also talk about the facts behind the figures. We'll be moving from slide 13 to slide 23, and I'll spend some time on each of the metrics. Kindly join me as we move to slide 13.

Largely, as the DMD mentioned, we started 2017 with some cautious optimism. And to a large extent, that feeling still remains. What we've seen in the last few months is we have relatively high interest rates regime and that has flown into the performance of the bank.

If you look at the right-hand side, you'll see numbers on H1 2017, H1 2016 and the full year 2016 numbers. The top one shows improvement in gross earnings from 24 billion to 30 billion. Improvements in PBT from 1.3 billion to 1.43 billion. There was a dip in deposits from 283 billion at the year end to 251 billion. This is largely in a bid to reprice and refocus the balance sheet, and this happened in the months of May and June. I will spend some more time on deposits and liabilities as we go on.

Yield on assets is up from 15.65 at the year end to 15.95. NPL still remains within the regulatory threshold of 5%. We closed the full-year NPL at 5.07. At half-year, we are down to 4.91%.

Largely, in summary for this slide, what this slide show is that yes, the margins are getting tight, but this impact was largely offset by improved fee income and an efficient loan book.

If we move to slide 14, this shows the earnings trend of the bank. On the left-hand side, we have the breakdown of earnings into interest income and non-interest income. And then, the right-hand side shows some more graphic form of the breakdown of the elements. You see the interest income up from 20.16 to 25.37. But the interesting part is the fee-based income that has moved up by like 1 billion year-on-year. And a number of these fees are largely around the mobile and alternative channels. So in summary, what you see is improving fee income lines in addition to the better yield on assets.

Moving to slide 15, one of the key headwinds that impacted on the cost management largely remains around the high interest rate, around the high inflation rate. You see operating expenses have gone up by 5.02% from 11.39 billion to 11.97 billion. Drivers for this increase are mentioned here – higher energy cost, incremental cost from technology. A number of these technology costs, the foreign currency amounts remais stable but obviously, what happened was the naira element, given the impact of the exchange rate had gone up.

What the bank has done on the last few months is to put in place a number of measures around further management of its cost. So we launched the BPMS, the Business Process Management Suite, to streamline and reduce stationary and related cost. We've done a lot of things around SLAs, improving turnaround time. Largely, what you've seen from Wema Bank is a bank that has been able to keep a lid on its costs. Cost is growing on average 5%, despite inflation at 16%. Really, the key effort is growing revenue. And by driving revenue, better cost-to-income ratio.

If we move to slide 16, this begins to show the impact of the high interest rate environments on the bank's margins. What you see is that the high interest rate affected both sides of the balance sheet. On the left-hand side, you'll see better yield in assets and that was driven by re-pricing of risk assets, the higher yield in money and fixed income market.

Obviously, what happened was that this high environment also impacted on the cost of funds. Last year, we closed with cost of funds at 6.7%. By half-year, cost of fund is almost at the high end of the single digit mark. So same yields go up, but margins tightened. Good enough for the bank, we've been able to offset a lot of this with better fee income base. What we've done in the last few months is now start the process of gradually replacing our fixed deposits.

Unfortunately, what happened in the first three months of the year was, for tier II banks, fixed deposit pricing was to a large extent benchmarked against the risk free treasury bill rates. As we expect rates to start trending downwards in next few months, we are also pushing through for better re-pricing of our deposit liabilities.

Moving to slide 17, what this shows is that at the end of the day, one of the important things is the bottom line. And Wema Bank has demonstrated over the years, resilience and the ability to ensure and secure stable profits. The top chart shows PBT, 1.17 half year 2015, 1.3 half year 2016 and 1.4 half year 2017. And we can see that, interest income was up 25%, fee income up 21% to 26.83%. Interest expense, like I mentioned earlier, was also up around 30%, but we still allow this offset by the better fees and all resulting in PBT up 10% from 1.3 billion to 1.4 billion. So really, the focus for the bank is finding a way to continue to manage its interest expense while ramping up its fee-based income.

If we move to slide 18, what this shows is some further breakdown of the deposit liabilities. On the left-hand side, it shows the total deposits while the right shows the mix, and the chart below shows the deposit by type. What has happened was Wema Bank had to gradually reprice its deposit liabilities.

In the first two to three months of the year, like I mentioned earlier, we adopted a two-pronged strategy. Firstly, was to continue to ramp up customer acquisition through the digital bank, through USSD and through other partnerships. Secondly, was to initially work with PFAs and get a large chunk of deposits for strong stability. While the economy is improving and the payments are coming in from loans and advances, we started letting go of the slightly higher priced deposits in a bid to reprice the balance sheets, and you can see that impact. Fixed deposits used to be 56%; that has dropped to 47%. Yes, this happened late at the end of the first half. While a lot of the gains, we start translating to better margins in the second half of the year.

So largely for this slide, what you see is a bank working hard to replace its balance sheet and ensure some better efficiencies. So in the next half of the year, a number of these gains will start being seen in the net interest margin of the bank.

One of the key points for measure for any institution is the loan book. And if we move slide 19 – it shows the details of the loan book of the bank. 2016 numbers compared to 2017 first half numbers. Indeed, for Wema Bank, you still see a fairly diversified loan book. Oil and gas is at 19%. The majority of the oil and gas is downstream trading. The upstream element is 3.5%. And like, if you recall, as mentioned, at the full-year conference call, this also has dollar receivables. So they are locked in in terms of any impact of foreign currency changes.

Other sectors remain quite diverse. I tried to put the definitions of the sectors in the footnotes on the right. So largely for the bank, you'll see a slight reduction on the loan book from 228 to 208. We're able to get a number of paydowns as the economy improved for one or two customers within the retail space – the general commerce space. Largely for us, it was a fairly diverse loan book. We'll continue to manage this. The key impacts of the loan book are the NPL numbers which we'll see on slide 20.

Slide 20 shows NPL ratio from 2016 to 2017. At the end of year 2016 we closed the NPL up 5.07%. Now, it's slightly higher than the regulatory threshold of 5%. The numbers that we see was below the industry average of 15%/16% in terms of NPL. The unaudited numbers show 4.91%.

We think with the economy is improving slowly month by month, the worst is behind us in terms of product provisioning and additional NPL of the bank. So by end of the year, probably we'll see NPL still hover around the 4% to 5% mark. The chart on the right shows the breakdown by sector of the NPLs of the bank.

Moving on to slide 21, this talks largely around the capital adequacy and long-term funding of the bank. On the bottom right-hand, you'll see the breakdown of funding, deposits, shareholders' funds and what have you. Wema Bank closed at the half year point with a capital adequacy ratio of 12.71%. You will recall that with commercial bank with national authorisation, the minimum threshold is 10%. So we are above the minimum at 12.71%.

There's been some improvements from end of year to this year. That was on the back of the slight drop in the risk asset. Also, certain refinancing that happened during the year. And what that does is that, by refinancing, it improves the credit risk mitigants, and that lowers the risk weighted assets of the bank.

The capital adequacy ratio is up to 12.7%. It is still above the regulatory threshold. What the bank is doing is continuing to monitor both the money market and the fixed income market, to take a view on its second tranche of its tier II raise. But even at the 12.71%, and this doesn't include capitalised earnings, we think this capital adequacy ratio is still enough to support the bank's organic growth strategy.

Moving onto slide 22, this continues to talk to risk management. We spent some time on the deposit book. We spent some time on the loan book. There are other risks, other headwinds that impact or affect the banking environment. A number of them we listed here.

Government remains key. The ability of the government to stimulate the economy – it's important to commercial bank. Technology and cyber-risks also imagine we've seen a number of threats in the last couple of months. The WannaCry virus and a number of attacks, both locally and internationally. Also as the election cycles starts getting nearer, political risk is also going to be a major factor the bank must watch out for. Largely for us in Wema Bank, we continue to manage these risks and ensure that we'll protect the assets of the bank to providers of capital.

In summary, if you go to slide 23, this shows the five-year trend on a number of financial indices. And like I mentioned earlier, the economic headwinds are still there, though it's improving, as we've seen from the numbers from the Bureau of Statistics. So Wema Bank, what we've done is focus quickly on restructuring the balance sheets and start driving efficiencies for the second half of the year.

What we see in NPL numbers, this remains quite low, and we don't foresee any major spikes except some significant deterioration in the economy. Capital adequacy up 12.7. We think we'll remain around the lower double-digits between now and the end of the year. We don't foresee any major dip within that space. The strategy for us remains to continue to drive our organic growth through digital channels while finalising the balance efficiency initiatives that we started at the beginning of the year.

At this point, I will hand over to Mr Ademola Adebise for the concluding parts of the presentation. Thank you.

Ademola Adebise

Thank you, Tunde.

We'll go to slide 25. Slide 25 just talks around the outlook of how do we see H2 for the economy. We believe that the economy is on a growth trajectory. It's on a positive – it's moving in the positive – in the right direction. Save for some political risks along the line of – impact of some actions of OPEC, on oil prices, I would believe that H2 – we should see a better H2 for the economy and, by extension, for Wema Bank.

Inflation rates though, still moderate, and it is coming – trending downwards. We believe that for the rest of the year, interest rates may still be quite high. However, the improvements of the FX markets, again, we believe that that is subject to whatever happens in the global market.

On the whole, we believe that H2 for the economy and for Wema Bank will be much better. We will continue to hone our strategy – execute our strategy in an aggressive manner. As Tunde rightly said, we would pursue our strategy – the organic growth looking at an efficient balance sheet, pushing our digital bank to the next level, basically through alliances and partnerships. We will continue to improve on our brand by refreshing our physical locations for better – for performance. Altogether, we believe that H2 will be much much better.

If you join me in slide 26, it talks about guidance. Again, as we said earlier, we're approaching the year with some cautious optimism. That is reflected in the guidance that we've show in here. We believe that deposit growths would – deposit will grow in a modest manner at 5%, and this will be driven largely from our digital channels. We also believe that the retail penetration will improve, as I said earlier on, with ALAT and with the agency banking which is still at the pilot fees right now. We believe that we should be able to improve our retail penetration strategy by – penetration by about 15%.

In terms of loan growth, as you rightly saw in the direction – in the numbers that Tunde has presented, loan growth – I mean, slow down on loans and we believe that loan growth will be in the neighbourhood of 1% to 2%. Again, this is part of trying to restructure our balance sheets to make it more efficient.

Where will income really come from if there's no loan growth? We are going to improve on our non-interest income through our digital channels. I showed you the numbers on ALAT, we believe that this is just a starting point. Towards the end of the year, we'll begin to ramp up more aggressively on these – on the – on the numbers from the digital space. So we believe that a 15% growth in non-interest income will reflect the strategy that we are trying to execute.

The top one here what we are committed to reach is a cost-to-income ratio. We intend to bring it down to about 80%, and also close between 6.5% and 7% on net interest margin. Basically, this we will achieve by ramping up. We're able to ramp up on our retail deposits. This will have a direct impact on the mix and on our cost of funds. And, of course, this will impact net interest income.

We also are doing quite a number of things on the operational side to bring down our cost to serve. We believe that with more customers that we bring on board, we'll be able to bring down cost to serve for our customers. And also internally too, we are working on a number of things. Just as we are going digital to our customers, we are also going digital internally. We are going towards a paperless office. A number of initiatives are on-going internally to ensure that this is achieved.

On this note, I'd like to thank everybody for joining us on this investor call, and I will now hand over for questions and answers.

Q&A

Operator

Thank you. Ladies and gentlemen, if you do wish to ask an audio question for the speakers, please press 01 on your telephone keypad. If you wish to withdraw your question, you may do so by pressing 02 to cancel. So that is 01 to register for a question. There will be a brief pause while questions are being registered.

Out first question comes from the line of Michael Akinyemi from Standard Chartered Bank. Please go ahead. Your line is now open.

Michael Akinyemi

Hello, good afternoon, and thanks for the presentation, and congrats on your performance in H1.

I just wanted to ask if Wema Bank – I mean, looking at the real estate exposure, I just want to check if you have any exposure to InterContinental Hotels, just to get a sense of the size of the exposure and what is the state of it – is it performing? I mean, if you can just shed more light on that. That will be great. Thanks.

Ademola Adebise
Well, thank you, Michael. We will try to maintain customer confidentiality by not mentioning names. We can take this offline when – after the conference.

Michael Akinyemi
Okay. Thank you.

Operator
Our next question comes from the line of Oyin Ajayi from Meristem Securities. Please go ahead. Your line is now open.

Question
Hi, this is Oyin Ajayi from Meristem Securities. The first question is something about on customers. Where there 120 customers over a certain period? I just want to clarify if it's just 120 or it's 120,000 or I didn't get the number is right. Thank you.

Ademola Adebise
It's 120,000. It's correct.

Question
Thank you.

Operator
As a reminder, if you do have a question for the speakers, please press 01 on your telephone keypad now. There will be a pause while questions are being registered.

Our next question comes from the line of Afolabi Doyinsola from Afrinvest. Please go ahead. Your line is now open.

Afolabi Doyinsola
Okay. Good afternoon. Thank you for your presentation.

So, I would like to ask, in terms of corporate governance, we looked at your management team, and it looks like a huge chunk of people on your team are from the Southwest, and you're thinking of posing as a national bank. So is there – are there any plans to, you know, dissolve and then look at other regions, say South-South?

So number two question would be the recent restriction that has been on your digital bank, which is ALAT – it looks like a lot of customers are losing confidence. How are you going to resolve this? How are you going to be able to sustain the confidence going forward? And how has this ALAT project or ALAT campaign affected your cost-to-income – your cost-to-income and then your OpEx – all your OpEx? I like to know what percentage of ALAT has – what percentage of ALAT has eaten into your cost-to-income – your OpEx, rather, sorry.

And my third question would be – so for your ALAT, you said you are looking at about a thousand accounts per day. Has that been the trend recently? How sustainable is that? Is that 1,000 accounts a day, are you still on track? Thank you.

Ademola Adebise
Thank you, Afolabi. I will take the question.

On corporate governance, you are very spot on, and we are quite mindful of the spread on the board in terms of members of the South-West and we are actively working on this. Of course, you know, we are in the process. By 2018, we'll be looking at going on equity raise and we believe that this would impact the composition at the end of the exercise.

Also we are – beyond even equity raise, we are actively working on it to ensure that we have a national spread. We have gone national and, of course, we need to reflect that. That is actually a valid – very, very spot on question.

In terms of ALAT, how is ALAT affecting – the restrictions on ALAT affecting… I need to explain. ALAT – we are governed by the Central Bank regulations. And basically, KYC is a very key aspect of that. And we cannot open an account without completing KYC. What happens is you have to capture your selfie and your signature on the phone. When we first started, it was selfie, signature, utility bills and then means of ID. But because of the restrictions, I know that all we've done is to bring it down to tier

3, which only requires you to just have your selfie and your signature, and that is all we have to day. That's how we have managed data.

The agitations have actually reduced. We are managing our customers, and those on restrictions, we're also migrating them on too. The only restriction there, or the only limitation, is the fact that you will probably not be able to do more than 500,000 in terms of transactions every day, 500,000 balance, and in terms of a single transaction, maybe 30,000 basically. Based on the rules of tier 3, as stipulated by the Central Bank of Nigeria.

Now, when you then open the account and you start running it, you can then upload the other requirements to enable us and move you automatically to the other tiers of accounts, and that's what – we have one called ALAT Lite. ALAT Lite is actually the tier 3, which is the lowest form of account opening, and then you move on to ALAT. And then, of course, subsequently, you're going to move on to ALAT Plus which is what – that is going to support the SMEs and the current accounts. So that's on ALAT.

The feedback is very positive, I must say. Yes, we had initial teething problems like any other new product, but it's improving and I showed the numbers are here during the presentation, and we are quite optimistic that it will succeed.

Now, in terms of a number of accounts, our target was 1,000 – actually, our target for ALAT is 350,000 in one year with an average of 1,000 per day. Today, we have enabled 500 to 550. We are working on ramping this up but we're not there yet, but we're working on this.

Tunde will handle the other question on impact on OpEx.

Tunde Mabawonku

Okay, thank you, sir. Like you mentioned, for the customer numbers, we have a chart to show how we intend to ramp up in the next couple of months. So we started now. In 60 days we've done our strategies for our 6,000 new customers. And increasingly one of the other initiatives, the additional campus storms, the radio jingles, the YouTube advertisement, a lot of other key drivers come to market, and then we see the numbers ramp up.

In terms of cost to income, in the first 12 months – first nine months of the launch, we don't expect any major impact on cost-to-income directly from ALAT. Then, increasingly, once you pass the 250,000 mark in terms of new accounts, then we start seeing cost to serve dropping significantly. The target is that we – the contribution of ALAT Plus, the traditional Wema Bank, cost-to-income has started dropping down to the 65% mark in 24 to 36 months.

So, yes, there are some costs, but the bulk of the ALAT costs evolve around software and internal development. Eventually some branding-related cost will come in. But by the 200,000 to 250,000 mark, and then it begin to start bringing down the cost-to-income. So the guidance for 2017 is to close at 80. The guidance for 2018 is to start bringing that down to the 65% mark. And then by 2019 or so, we think we'll be around industry average in terms of cost-to-income.

Thank you.

Afolabi Doyinsola

Hello

Ademola Adebise

Yes, please.

Afolabi Doyinsola

Yes, so I want to…

Operator

Our next question. sorry. You can keep on going.

Afolabi Doyinsola

Okay. Sorry. So, what about OpEx? How does it affect your operating expense?

Tunde Mabawonku

Okay. The bulk of the ALAT OpEx is largely two-fold; it was the staff cost, the amount of resources we spent in bringing in the intellectual capacity on ground work. ALAT was built in Nigeria and developed here in Nigeria by Nigerians. So a chunk of the cost is staff-related cost.

The other chunk of cost that starts coming up is advert and brand-related cost. And what we have done for those ones, the ones that are fixed in nature can be amortised, the one that have to be expense will be expense. So, yes, there are some incremental cost, but from the numbers ALAT will not add to the cost-to-income ratio from the numbers, but was rather – we started using it by the 200,000 mark.

Speaker
[Inaudible].

Afolabi Doyinsola
All right. Thank you.

Operator
Our next question comes from the line of Tolu Alamutu from Exotix. Please go ahead. Your line is now open.

Tolu Alamutu
Thank you very much for the presentation. I have three very quick questions if I may. The first question is on your margin. So you've given a target for this year, but I just wanted maybe to get some idea of what a more of medium term target might be for those margins and how you might achieve given what you mentioned about having to price deposits significantly higher than some of the first tier or top tier banks?

And the second question relates to capital. Do you have a capital ratio target for this year given that your – you say you're planning to add to tier II capital in this quarter? And do you think it's possible that your capital ratios might be more comparable to some of the larger banks in Nigeria over time?

And finally, a question on loan growth opportunities. I think you said that your loan growth target for this year is only around 1% to 2%. But could you please tell us whether that's a net or gross target in terms of whether it takes repayments into account or not? And if it is a net target, can you maybe tell us where you're seeing opportunities to lend. Thank you very much – where, in terms of sectors, I mean. Thank you.

Tunde Mabawonku
Okay. Thank you very much for the questions. Let me start with the capital adequacy and then I go to margin's loan growth question.

On capital adequacy, right now, we are on 12.71. What is our guidance for the year? Our guidance for the year is two-fold. Without the incremental tier II, our guidance for this year will be 12%. With the incremental tier II, we'll probably bring that up to around 14%. The incremental tier II, really, the execution is based on where we see the market going. We did the first charge last year with a coupon of 18.5. Our target is to see can we get that or below this year.

Unfortunately, the yield curve is a little bit inverted while investors prefer to play on the short end of the markets buying treasury bills are 21%, 22% rather than investing in longer term notes.

The key there for capital adequacy eventual will be tier I raise which we'll plan for later in 2018. What that then does is it gives us a lot more room to utilise or bring in additional tier II capital. So by using – maintaining the 12%, which is largely on the bank's core equity, by the time we bring in or do an additional tier I raise next year, then we start seeing CAR numbers inch up to 18%, 19%, close to the bigger tier I banks. But for the short-term, we see CAR around the 12% mark.

In terms of margins, what are the challenges, where do we see, how are we playing? Yes, we mentioned, margins have been tight. Obviously, what happened was that, in the first two months – two to three months of the year, rates were – indeed quite high. The liquidity was also tight in the system. What the bank has to do was to balance between liquidity and profitability and what cost should additional money be taken, at cost should we price. By May/June, when some better liquidity go to the market, we let go some of the more expensive [inaudible]. And the expectations is, as you ramp up on the retail numbers, the retail comes in trickles, so the ALAT that will open 30,000 or so accounts, the balances are still less than half a billion. But as this number starts ramping up on improving, then you start to see that and its impacts on the cost of funds.

So, for us, is the gradual growth in the deposit liabilities, where do we see margins? We think, in the short and medium term, it will be around the 6.5% or so mark. A lot is still hinged on the crowding out effects of the federal government and their borrowings. So they started on the savings bond, now treasury bills and rates are still quite high.

But from what we see are the centre. The high cost of borrowing was beginning to tail, and there are some concerns around what best or how best to manage that. Unfortunately, with inflation numbers still high, it's a double-edge sword that you have to juggle with. So largely, for us, we see margins at 6% to 6.5% on the back of the impact of this retail deposits coming in.

In terms of loan growth, yes, it's gross. What we've done is the repayments that have come in and improved liquidity we used that to offset – pay down on the expensive funds. And shorter cycle loans will be done. So rather than deploy more risk assets with real estate or construction, it's now the short-term trading cycle: 90-day, 60-day, 180-day, transactions that can cycle out. So what we want to drive, really, is a lot more liquidity in the loan book while gross numbers remain up to around 1% growth.

Ademola Adebise

Yeah. If I may add to what Tunde had said on capital ratios, if you've looked at our balance sheet, there's an item called deferred tax. That is actually an internal mechanism for also improving the capital adequacy ratio. As we become more profitable, we'll write-off the deferred tax. And that is basically a very, very good and in line with our organic strategy. That would – that's also another way of – as we become more profitable, we will write-off more deferred tax, that will bring down risk weighted assets and, of course, with the impact of improving capital ratios. Thank you.

Tolu Alamutu

Thank you very much.

Operator

As a final reminder, if you do have a question for the speakers then please press 01 on your telephone keypad now. There will be a further pause for questions are being registered. Please hold for the next question. Please hold while we take the details for the next person.

So our next question comes from the line of Onome Ohwovoriole from Nairametrics. Please go ahead. Your line is now open.

Onome Ohwovoriole

Okay. Good afternoon everyone. My questions go as follows. First is ALAT is wholly-owned by Wema Bank. I'd like to just to have a – you know, get confirmation on that. Then two, I was going through your NPL, you know, ratio according to sector. I see that the NPL ratio for general commerce is quite high, I think, about 40% or so. So I'd like to know your strategy for that going forward to bring that down. Thank you.

Ademola Adebise

ALAT is fully owned by Wema Bank.

Onome Ohwovoriole

Okay.

Ademola Adebise

It's not a subsidiary because we are not a HoldCo. It's a part of the bank. It's part of the bank, but it does have – it has its own – basically, with more or less, yeah, it has his own team, basically, with its own culture, with its own – you know, we're talking about millennials. So they have they their own ways of doing things. So basically, that's what we've created. We've created an enabling environment for it to thrive.

Onome Ohwovoriole

Okay.

Tunde Mabawonku

Okay. On the NPL by sector which you mentioned, general commerce, if you check, what we are trying to do on slide 19, what we've done is to show the definitions on what general and general commerce, were really largely – these are the trading entities. And a number of them, we are putting in that bucket. When the first – late last year, this is – some of them, on our ability on foreign exchange, our ability to clear down standing LCs on time, our ability to get some funding. So these have started dropping. So, really, for them is to cycle out and trade out their losses. So as the economy improves, what you see is the general commerce, the traders, this ratio will start to reduce and they start to get more liquidity, they start to pay down. So the strategy, first and foremost, was the impact of the macro environment, and that has helped availability of FX; that has helped all of these customers to time out the loans, so as they trade and get some more cash flows then they pay down.

Onome Ohwovoriole
Okay. Okay, that's good by me. Okay. Thank you.

Tunde Mabawonku
Thank you.

Operator
As there are no further questions registered, I will return the conference back to the speakers.

Ademola Adebise
Thank you. Ladies and gentlemen, we thank you for joining us on this call. As we said, we're committed to our customers, we're committed to ensuring to our stakeholders, to ensuring that we improve on the growth trajectory of the bank. We will, as we promised, work very hard, very aggressively to ensure that our guidance stays as it is by year end. We hope that you will also join us next quarter on the conference. Thank you. On behalf of my colleagues, I'd like to thank everybody. Thank you very much. Good bye.

Operator
This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.