FitchRatings

Banks
Universal Commercial Banks
Nigeria

Wema Bank PLC

Key Rating Drivers

Standalone Strength Drives IDRs: Wema Bank PLC's Issuer Default Ratings (IDRs) are driven by its standalone creditworthiness, as expressed by its Viability Rating (VR).

Wema's VR is conditioned by Nigeria's operating environment, with weak macroeconomic conditions, policy uncertainty and regulatory intervention influencing the bank's standalone creditworthiness. The VR also reflects a nominal franchise, tight capitalisation and leverage metrics and a weak funding structure relative to peers', balanced against good loan quality and adequate profitability.

Small Franchise: Market shares of loans and deposits of around 1% are modest, but brand recognition is improving as a result of Wema's unique digital offering. Fitch Ratings expects market shares to increase in line with Wema's ambitious growth strategy. Wema has a high cost of funding that limits pricing power compared with larger peers. Wema operates exclusively in Nigeria and has no subsidiaries.

Good Asset Quality: Wema's impaired loans (Stage 3 loans under IFRS 9) ratio (2.3% at end-9M19) is consistently lower than the sector average and Stage 2 loans (a further 0.9% of gross loans at end-9M19) are also low. However, single-borrower concentration is exceptionally high, with the largest 20 exposures measuring at 450% of Fitch Core Capital (FCC) at end-1H19. In addition, strong loan growth may lead to future asset quality weaknesses.

High Leverage: Wema's FCC ratio (12.5% at end-9M19) is one of the weakest in the sector. Tangible leverage (5.5% at end-9M19) is particularly weak following strong deposit growth in 2018 and 9M19 that has inflated the size of Wema's balance sheet. These weak metrics are also considered in the context of very high single-borrower concentration and weak internal capital generation. Positively, Wema is considering a rights issue to fund continued growth, which could bring leverage back to acceptable levels.

Weak Funding Structure: Wema's funding profile is structurally weaker than peers' given the bank's greater reliance on more expensive and less stable term deposits. Coverage of asset and liability maturity mismatches by unpledged liquid assets is also less comfortable than peers'. Positively, Wema is almost entirely funded in local currency and, therefore, foreign currency (FC) liquidity risks are less of a concern.

Adequate Profitability: Profitability metrics are broadly in line with similar sized peers'. Profitability continues to be constrained by a weak net interest margin and a high cost-to income-ratio. Fitch sees limited prospect for a material reduction in Wema's cost of funding and cost-to-income ratio. Profitability metrics will therefore remain constrained as Wema pursues its ambitious growth strategy.

No Sovereign Support: Fitch believes that sovereign support for Nigerian banks cannot be relied on given Nigeria's weak ability to provide support, particularly in FC.

National Ratings: Wema's National Ratings reflect its creditworthiness relative to other issuers in Nigeria and are driven by its standalone strength. They are at the lower end of the scale reflecting Wema's weaker company profile and financial metrics relative to peers'.

Rating Sensitivities

Asset Quality: Wema's ratings are primarily sensitive to deterioration in asset quality, which would lead to a knock-on effect on profitability and capital. The ratings are also sensitive to continued strong levels of loan and balance sheet growth that pressure capital metrics. Upside potential is currently limited by the bank's small franchise.

Ratings

Long-Term IDR	B-
Short-Term IDR	B
Viability Rating	b-
Support Rating	5
Support Rating Floor	No Floor
National	
National Long-Term Rating	BBB-(nga)
National Short-Term Rating	F3(nga)
Sovereign Risk	
Foreign Currency LT IDR	B+
Local Currency LT IDR	B+
Country Ceiling	B+
Outlooks/Watches	
Long-Term IDR	Stable
Sovereign Foreign Currency Long-Term IDR	Stable
Sovereign Local Currency Long-Term IDR	Stable

Applicable Criteria

Bank Rating Criteria (October 2018)
Short-Term Ratings Criteria (May 2019)
National Scale Ratings Criteria (July 2018)

Related Research

Nigerian Banks: 2019 Peer Review (July 2019)
Nigeria (June 2019)
Fitch Affirms Wema Bank PLC at 'B-' (Nov 2019)

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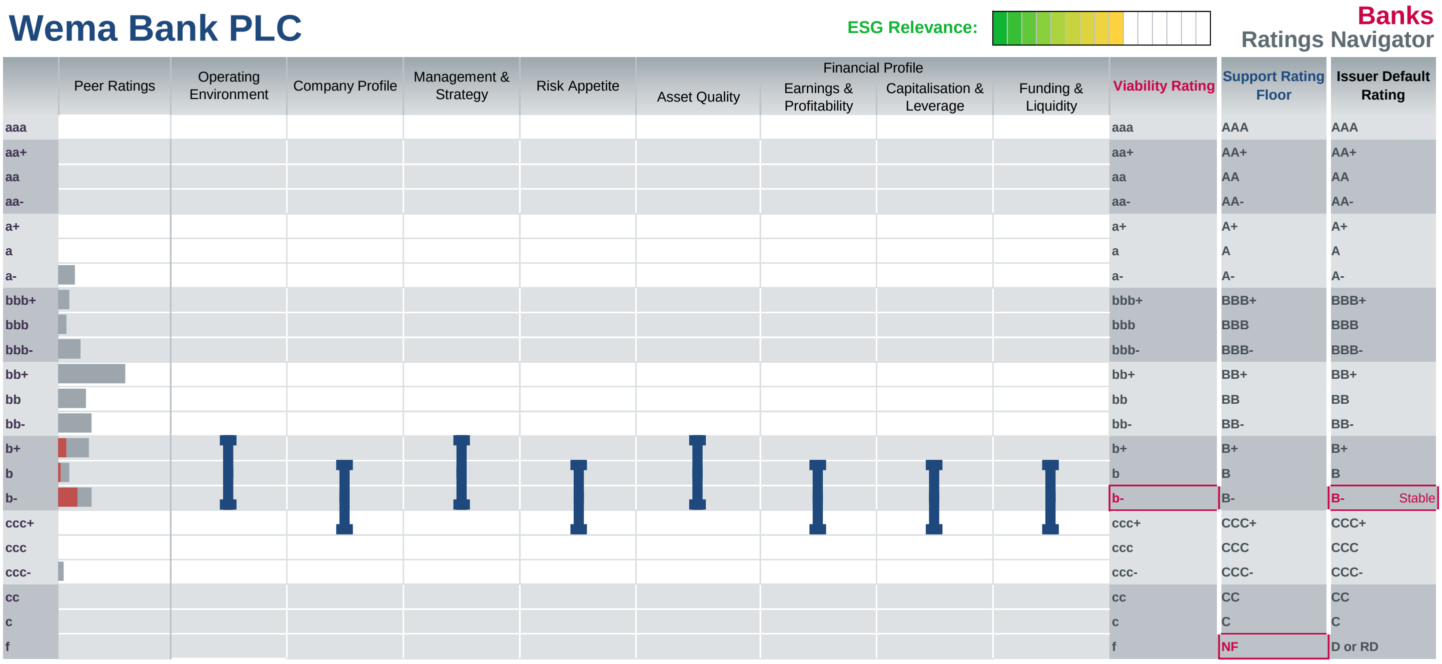
Standalone Assessment



Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			B+
Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy	✓		
Size of potential problem			✓
Structure of banking system		✓	
Liability structure of banking system			✓
Sovereign financial flexibility (for rating level)			✓
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in		✓	
Track record of banking sector support	✓		
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank			✓
Ownership		✓	
Specifics of bank failure		✓	

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧ Positive ⇩ Negative

⇳ Evolving ▫ Stable

High Propensity to Support; Weak Ability

Fitch considers the authorities' propensity to support the banking system to be high and there is a record of recent support across the sector.

However, Fitch believes that sovereign support to Nigerian banks cannot be relied on given Nigeria's (B+/Stable) weak ability to provide support, particularly in FC. The size of the banking sector is small by international standards (at about 30% of GDP) but government finances remain weak. Therefore the Support Rating Floor of all Nigerian banks is at 'No Floor' and all Support Ratings are at '5'. This reflects our opinion that senior creditors cannot rely on receiving full and timely extraordinary support from the Nigerian sovereign if any of the banks become non-viable.

Significant Changes

Minimum Loans-to-Deposits Ratio of 65%

Loan growth for the sector remained weak in 2018 (private sector credit contracted by 5%) due to weak operating conditions, persisting asset quality problems and the crowding out of private sector credit from investments in high yielding government securities.

In order to encourage banks to resume lending (particularly to consumers and SMEs) and stimulate economic growth, the Central Bank of Nigeria (CBN) introduced a minimum loans-to-deposits ratio (LDR) of 60% to be reached by end-3Q19, and subsequently increased this to 65% to be met by end-2019. The LDR is effectively a loans-to-funding ratio as the denominator includes all funding except interbank borrowings. Banks that do not meet the threshold are required to place additional unremunerated cash reserves at the CBN equal to 50% of the LDR lending shortfall. Wema is in compliance with the 60% requirement.

CBN intervention in the banking sector and unconventional policy measures is credit negative for banks. The LDR forces banks to increase lending in a very short timeframe to untested segments (consumers and SMEs) during a period in which operating conditions are not conducive to growth, which could increase asset quality risks and pressure capitalisation, while also creating margin compression as competition for quality borrowers intensifies. Bank liquidity will also be affected as a result of the shift away from government securities, which will also affect capital ratios. Earnings will be further affected if banks are required to place additional cash reserves for not meeting the LDR.

Tough Operating Environment

Operating conditions in Nigeria remain challenging. Fitch forecasts 2% GDP growth for 2019 (1.9% in 2018), which will be largely driven by the non-oil sector and stable oil output. Nigeria is highly reliant on oil and gas (as Africa's largest producer), with the sector contributing around 10% of GDP and 45% of government revenue. Lower average oil prices and OPEC-imposed production cuts weigh on the sector. Inflation remains high but stable at around 11% in 2019; pressure could come from food price hikes, the new minimum wage and VAT increases.

Monetary policy aims to strike a balance between supporting the naira and controlling import inflation. The CBN has recently attempted to boost economic activity, starting with a policy rate cut to 13.5% in March (from 14%) and then directly intervening in the banking sector through regulations and policies to encourage banks to resume lending. In addition to the LDR requirement, the CBN has limited the amount of remunerable deposits banks can place at the CBN and is introducing a limit on the amount of government securities banks can hold in an attempt to stimulate credit growth.

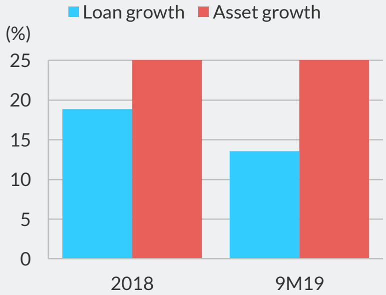
Nigeria's improving international reserves (USD44.9 billion at end-1H19) provide a large external buffer. However, around USD6 billion of reserves are pledged in forward positions. Reserves are also buoyed by non-resident holdings of short-term CBN bills, which totalled USD15.8 billion (4% of GDP) at end-April 2019, exacerbating susceptibility to reversals in volatile portfolio inflows and generating rollover risks.

Balance Sheet Growth a Key Risk

Wema's ambitious growth strategy presents a key risk. Strong asset growth in 2018 (26%) and 9M19 (25%) has been largely funded by corporate term deposits, which has served to increase Wema's already high reliance on expensive and less stable term deposit funding. Furthermore, this exceptionally strong deposit growth has exerted considerable downward pressure on leverage metrics. Loan growth also continues to outpace the sector at a time when the operating environment is not conducive to loan expansion. This may lead to future asset quality weakness and, in turn, affect profitability and capital metrics.

We expect strong loan and asset growth to continue in line with Wema's ambition to increase market share, which will put further pressure on solvency metrics. Positively, Wema is planning to support future balance sheet growth with a rights issue.

Asset Growth



Source: Fitch Ratings, Wema

Company Summary and Key Qualitative Assessment Factors

Nominal Franchise

Wema is a third-tier bank that accounts for around just 1% of Nigeria's banking system assets, loans and deposits. However, Fitch expects these market shares to grow in coming years as Wema pursues an ambitious growth strategy. Wema's small franchise translates into a high cost of funding and a lack of pricing power compared with larger banks.

Wema's customer base is more focused on small and medium-sized corporates than larger peers. Wema operates exclusively in Nigeria under a national banking licence and has no plans to create an international subsidiary. Non-interest income, which is typically split evenly between net fees and commissions and trading income, accounts for a healthy proportion of operating income (averaging 35% during the past three full years), supporting earnings diversification.

Unique Digital Offering

A key element of Wema's strategy and franchise is its fully digital offering. Using Wema's mobile platform, namely ALAT, customers are able to open a bank account and start conducting transactions without having to physically visit a branch. ALAT also has other unique features, such as allowing money withdrawals from an ATM without using a physical card. Fitch understands that ALAT, which was launched in 2017, is the first offering of its kind in Nigeria and is continuing to garner brand recognition, particularly from younger people.

Wema intends for ALAT to grow customer numbers sharply, thereby helping to mobilise retail deposits and reduce reliance on more expensive and less stable corporate term deposit funding. However, ALAT's funding contribution remains low at just 1% of customer deposits at end-9M19. Fitch understands that loans extended through ALAT remain very low and that the platform will maintain a liability-driven focus. Fitch recognises that competition is high in Nigeria's digital banking segment, which is dominated by the sector's largest banks, and this may limit ALAT's growth potential.

Wema continues to invest heavily in its digital offering in pursuit of being Nigeria's most innovative bank. In addition, Wema has invested heavily in marketing and advertising in an attempt to improve brand recognition, driving a high cost-to-income ratio that acts as a major constraint on profitability.

Limited Exposure to Troubled Sectors

Wema's underwriting standards are limited by its small franchise. This limits customer selection and results in a high proportion of lending to small and medium-sized corporates, which are typically riskier.

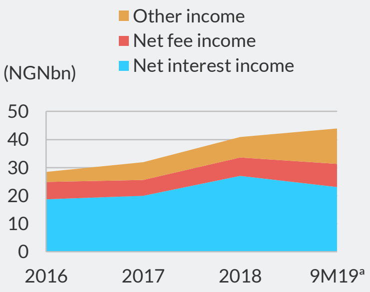
However, Fitch views positively Wema's lower exposure to troubled sectors, such as upstream oil and gas and power, compared with larger banks. Wema also limits lending to the entire oil and gas sector to 20% of gross loans, which is a more prudent limit than peers that comply with the 20% regulatory limit by each individual channel (e.g. downstream, upstream). Positively, FC lending (14% of net loans at end-1H19; largely in USD) is lower than peers', reflecting a customer base whose revenues are largely in NGN.

Single-borrower concentration is a key risk. Wema's largest 20 exposures (on- and off-balance sheet) measured at 450% of FCC at end-1H19, which is significantly higher than at any other Fitch-rated bank in the sector, making capital vulnerable to the default of individual borrowers.

Small Foreign Currency Balance Sheet

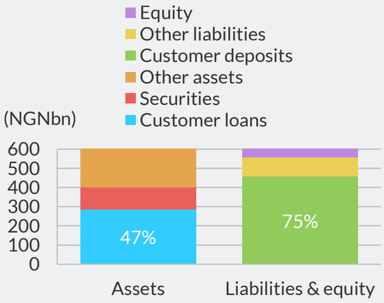
Wema has a significantly smaller FC balance sheet than peers, serving to reduce structural foreign exchange risk. Wema continues to run a long net open position in FC (largely in US dollars) equivalent to 24% of total equity at end-2018, meaning that a depreciation of the Nigerian naira would lead to a currency translation gain.

Revenue Breakdown



[a] Annualised data
Source: Fitch Ratings, Wema

Balance Sheet, Sep 19



Source: Fitch Ratings, Wema

Summary Financials and Key Ratios

	30 Sep 19	31 Dec 18	31 Dec 17	31 Dec 16
	9 months - 3rd quarter	Year end	Year end	Year end
	NGNbn	NGNbn	NGNbn	NGNbn
	Unaudited	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement				
Net interest & dividend income	17.2	27.0	19.9	18.7
Net fees and commissions	6.2	6.6	5.6	6.2
Other operating income	9.4	7.3	6.3	3.6
Total operating income	32.9	40.9	31.9	28.4
Operating costs	26.6	32.6	26.8	24.8
Pre-impairment operating profit	6.2	8.3	5.1	3.7
Loan & other impairment charges	1.6	3.5	2.2	0.4
Operating profit	4.6	4.8	3.0	3.2
Other non-operating items (net)	0.1	0.0	0.1	0.0
Tax	0.6	1.5	0.8	0.7
Net income	4.1	3.3	2.3	2.6
Other comprehensive income	0.1	0.0	0.1	-0.2
Fitch comprehensive income	4.1	3.3	2.4	2.4
Summary balance sheet				
Gross loans	297.1	261.6	220.1	229.8
- Ow impaired	6.8	13.1	2.5	2.4
Loan loss allowances	10.1	9.4	4.2	2.8
Net loans	286.9	252.2	215.8	227.0
Interbank	36.4	18.2	1.2	5.3
Derivatives	n.a.	n.a	n.a	n.a
Other securities & earning assets	115.4	92.2	69.9	78.9
Total earning assets	438.8	362.6	287.0	311.1
Cash and due from banks	121.9	82.7	58.4	70.5
Other assets	50.9	43.5	42.2	42.4
Total assets	611.6	488.8	387.5	424.0
Liabilities				
Customer deposits	456.8	369.2	254.5	283.3
Interbank and other ST funding	30.6	4.6	47.6	45.7
Other LT funding	45.6	45.4	23.9	25.7
Trading liabilities and derivatives	n.a	n.a	n.a.	n.a.
Total funding	533.0	419.2	326.0	354.6
Other liabilities	24.9	18.7	11.9	14.5
Pref. shares and hybrid capital	n.a.	n.a.	0.0	6.4
Total equity	53.7	50.9	49.6	48.5
Total liabilities and equity	611.6	488.8	387.5	424.0
Ratios (annualised as appropriate)				
Profitability				
Operating profit/RWA	2.4	2.5	1.7	1.7

Summary Financials and Key Ratios

	30 Sep 19	31 Dec 18	31 Dec 17	31 Dec 16
NII/average earning assets	5.4	8.3	6.8	7.3
Non-interest expense/gross revenues	81.0	79.7	83.9	87.2
Net income/average equity	10.5	6.6	4.6	5.4
Asset quality				
Impaired loans ratio	2.3	5.0	1.2	1.1
Growth in gross loans	13.6	18.9	-4.3	n.a.
Loan loss allowances/impaired loans	148.9	71.6	167.2	117.9
Loan impairment charges/average gross loans	0.8	1.3	0.9	0.1
Capitalisation				
Fitch Core Capital ratio	12.5	15.7	15.8	13.6
TCE ratio	5.5	6.4	7.6	6.5
CET 1 ratio	n.a.	n.a.	n.a.	n.a.
Basel leverage ratio	n.a.	n.a.	n.a.	n.a.
Net impaired loans/FCC	-10.2	12.5	-6.2	-1.7
Funding & liquidity				
Loans/customer deposits	65.0	70.9	86.5	81.1
LCR	n.a.	n.a.	n.a.	n.a.
Customer deposits/funding	85.7	88.1	78.1	78.5
NSFR	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings

Key Financial Metrics – Latest Developments

Good Asset Quality

Loan quality is a rating strength. Wema's impaired loans (Stage 3 loans under IFRS 9) ratio (2.3% at end-9M19) is consistently lower than the sector average and Stage 2 loans (a further 0.9% of gross loans at end-9M19) are also low, explained by limited exposure to troubled sectors that have caused asset quality pressures for larger banks, such as power and upstream oil and gas, in addition to considerably lower lending in FC. Specific coverage of impaired loans (69% at end-9M19) is adequate and Wema prudently maintains a large general provision that increased total loan loss allowance coverage of impaired loans to a high 149% at end-9M19.

Strong loan quality metrics are balanced against exceptionally high single-borrower concentration and strong loan growth during a period that is not conducive to loan expansion. The latter has served to flatter some asset quality metrics but may lead to pressures on future loan quality.

Adequate Profitability

Wema produces adequate profitability that is broadly in line with similar sized peers, as highlighted by operating returns over risk-weighted assets that have averaged 1.9% over the past four full years. Profitability is supported by good asset quality and low loan impairment charges.

However, profitability continues to be constrained by a weak net interest margin, which is explained by a high cost of funding, in addition to a high cost-to-income ratio. Fitch sees limited prospects for a material reduction in this ratio given continued investments in marketing and digitalisation and expected balance sheet growth that will inflate regulatory costs (deposit insurance and AMCON levy). Furthermore, Wema's ambitious growth strategy means that reliance on expensive funding is expected to continue, providing limited scope for improvement in the net interest margin.

High Leverage

Capital metrics are a rating weakness. Wema's FCC ratio (12.5% at end-9M19) is one of the lowest among Fitch-rated Nigerian banks and has declined in line with the bank's strong loan growth. Tangible leverage (5.5% at end-9M19) is exceptionally weak following strong deposit growth since end-2017 that has inflated the size of Wema's balance sheet. Positively, Wema is considering a rights issue to fund continued growth, which could bring leverage back to acceptable levels.

Weak capitalisation and leverage metrics are also considered in the context of very high single-borrower concentration. Pre-impairment operating profit is weak, providing limited buffers to absorb asset quality shocks, but asset quality positively does not compromise solvency given low levels of problem loans and comfortable provisioning.

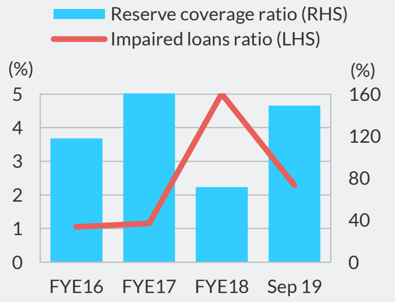
Wema operates with a national banking licence, meaning that it must comply with a minimum Total Capital Adequacy Ratio (CAR) of just 10%. Wema's CAR was 14.8% at end-9M19 (including unaudited earnings), providing a comfortable buffer above this modest regulatory requirement. Wema issued tier 2 capital qualifying subordinated debt in 2018 and 1H19, providing a boost to CAR, but no further tier 2 issuance is planned.

Weak Funding Structure

Wema's funding profile is structurally weaker than peers, with greater reliance on more expensive and less stable term deposits (54% of customer deposits at end-9M19) driving a high cost of funding. Retail deposits accounted for 37% of customer deposits at end-9M19, providing some stability to Wema's funding profile.

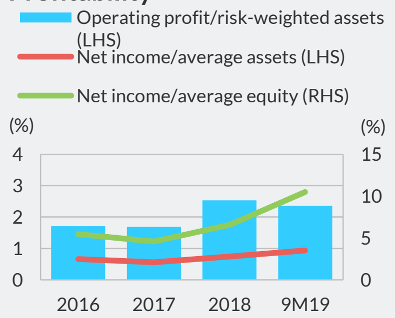
Wema runs particularly large asset and liability liquidity mismatches given that 86% of liabilities matured within three months at end-2018. Wema's loans/customer deposits ratio is low (65% at end-9M19), yet the bank's liquidity profile is weaker than peers, with liquid assets accounting for a smaller proportion of customer deposits due to a high volume of pledged securities. Positively, Wema is almost entirely funded in local currency, meaning that it is less exposed to FC liquidity risks.

Asset Quality



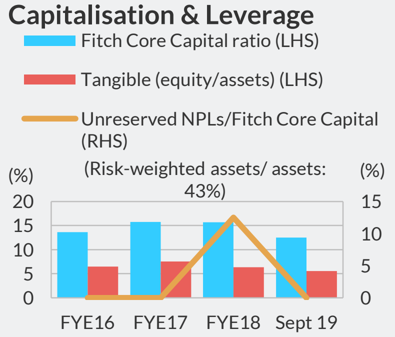
Source: Fitch Ratings, Wema

Profitability



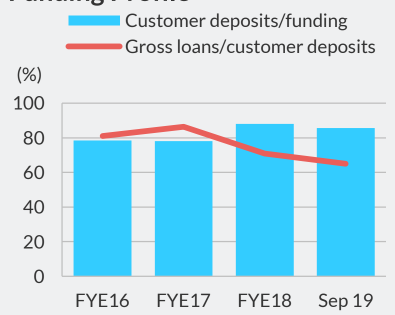
Source: Fitch Ratings, Wema

Capitalisation & Leverage



Source: Fitch Ratings, Wema

Funding Profile



Source: Fitch Ratings, Wema

Environmental, Social and Governance Considerations

FitchRatings **Wema Bank PLC**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Wema Bank PLC has 5 ESG potential rating drivers

- Wema Bank PLC has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The left-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies the [number of] general ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.