Wema Bank Plc

2022 Abridged Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

WEMA BANK PLC

Rating Assigned:

Bbb

ESG Score:

3

Outlook: Stable
Issue Date: 16 June 2022
Expiry Date: 30 June 2023
Previous Ratings: Bbb-

Industry: Banking

Analysts:
Ihuoma Udensi
ihuomaudensi@agusto.com

Ayokunle Olubunmi, CFA
kunleolubunmi@agusto.com

Agusto & Co. Limited
UBA House (5th Floor)
57, Marina
Lagos
Nigeria

www.agusto.com

A financial institution of satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due.

RATING RATIONALE

Agusto & Co. hereby upgrades the rating of Wema Bank Plc ("Wema Bank" or "the Bank") to "**Bbb**". The rating reflects the Bank's moderate retail franchise, particularly in the South-West region and the well-experienced management team. We have also factored in Wema Bank's improving profitability ratios, good liquidity profile and acceptable asset quality. However, offsetting these positive factors are the low market share, elevated cost profile, and prevailing macroeconomic and regulatory headwinds which restrains Wema Bank's profitability metrics. An ESG score of **"3"** has also been attached to the rating of Wema Bank.

Wema Bank Plc is the oldest indigenous bank in Nigeria and has over the years metamorphosed into a mid-sized commercial bank with a focus on retail and small and medium-sized enterprises (SMEs). As at 31 December 2021, Wema Bank controlled 2.5% of the banking industry's balance sheet size with a total assets and contingents of ₦1.2 trillion. Wema Bank primarily lends to obligors in the general commerce sector and general sector (individuals and SMEs) which accounted for 18% and 17% respectively of the loan book as at 31 December 2021. We believe these sectors are vulnerable to the prevailing macroeconomic headwinds although we expect the Bank's robust risk management framework to continue to uphold loan quality in the near term. Despite the fragile macroeconomic environment, Wema Bank's non-performing loans remained stagnant at ₦19.2 billion as at 31 December 2021, largely backed by write-offs and loan restructuring. This translated to a lower NPL ratio of 4.4% (FYE 2020: 5%), due to a 16.1% loan book expansion. While Wema Bank's impaired ratio was higher than its selected peers, it was lower than the banking industry's average of 6.5%. Overall, Agusto & Co. considers Wema Bank's asset quality to be acceptable although we believe the prevailing macroeconomic headwinds will continue to test the resilience of the Bank's risk management framework.

During the financial year ended 31 December 2021, Wema Bank's net interest spread improved to 54.4% (FY 2020: 48.9%) on the back of better funding mix. Income from ancillary activities rose by 11.9% to ₦18.8 billion, buoyed by higher income from management fees and electronic products. Owing to inflationary pressures and business expansion costs, Wema Bank's operating expenses expanded by 24.6% to ₦44.9 billion in FY 2021. Notwithstanding, the cost-to-income ratio declined to 78.1% (FY 2020: 85.9%) due to the higher net earnings base. Given the improvement in earnings coupled with lower loan loss provisions, the Bank's profit before tax rose materially by 108.3% year-on-year to ₦12.3 billion in FY 2021 and translated to better profitability metrics; with pre-tax return on average assets (ROA) and pre-tax return on average equity (ROE) at 1.1% (FY 2020: 0.6%) and 20.3% (FY 2020: 10.7%) respectively. We view Wema Bank's improved profitability positively and expect it to continue to trend upwards in the near term on the back of the projected loan book growth and sustained digitisation efforts. However, our expectations may be somewhat moderated by anticipated higher costs given sustained inflationary pressures and expected costs from planned branch expansion in the South-East region.

Wema Bank's shareholders' funds stood at ₦70.3 billion as at 31 December 2021, 18.6% higher than the prior year and well above the ₦25 billion regulatory minimum. However, the enlarged loan book moderated the capital adequacy ratio to 11.7% (FYE 2020: 15%), albeit higher than the 10% regulatory threshold. Subsequent to the year end, Wema Bank completed a reconstruction of the Bank's paid up share capital. Following the share reconstruction exercise, Wema Bank plans to raise capital through a rights issue exercise to support its medium-term growth plans. We believe the planned capital raise may be constrained by the fragile macroeconomic environment and the uncertainties associated with a pre-election year. Given the planned loan growth and business expansion, we believe that there is need to raise additional capital to further enhance the Bank's competitiveness.

Supported by the Bank's sustained digitalisation drive across the ALAT digital platform and other alternative channels, Wema Bank's deposit liabilities expanded by 15.2% to ₦927.4 billion as at FYE 2021. The growth in deposits was most prominent in low-cost (demand and savings) deposits which increased by 18.8% and accounted for 46.4% (FYE 2020: 43.6%) of local currency deposits as at FYE 2021. Given the improved funding mix, the Bank's weighted average cost of funds (WACF) declined to 3.5% (FY 2020: 4.3%). We anticipate that the WACF may be higher in the near term, on the back of the gradual rise in interest rates. We consider the funding base of the Bank to be satisfactory.

Based on the aforementioned, we hereby upgrade the rating of Wema Bank Plc to **"Bbb"**.

Strengths

- Strong brand in the South West region of Nigeria
- Improving profitability
- Satisfactory funding profile
- Experienced management team

Weaknesses

- High cost-to-income ratio
- Low market share despite age of the instituition

Challenges

- The impact of the fragile economic recovery on creating quality risk assets
- Regulatory constriants that adversely impacts profitability
- The impact of inflationary pressures on operating costs

Table 1: Background Information

	31 December 2020	31 December 2021
Total Assets & Contingents	₦1 trillion	₦1.2 trillion
Net Earnings	₦42.1 billion	₦56.6 billion
Pre-tax Return on Average Assets & Contingents (ROA)	0.6%	1.1%
Pre-tax Return on Average Equity (ROE)	10.7%	20.3%

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UBA House (5th Floor)
57 Marina Lagos
Nigeria.
P.O Box 56136 Ikoyi
+234 (1) 2707222-4
+234 (1) 2713808
Fax: 234 (1) 2643576
Email: info@agusto.com