Wema Funding SPV Plc

Series II ₦17.7 billion 16.5% 7-year Fixed Rate Bond

2022 Abridged Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Wema Funding SPV Plc

Series II ₦17.7 billion 7-year Fixed Rate Bond under the ₦50 billion Debt Issuance Programme

Rating Assigned:

Bbb+

Outlook: Stable
Issue Date: 17 Oct 2022
Expiry Date: 10 Sept 2023
The rating is valid throughout the life of the instrument but will be subject to periodic monitoring and review.

Previous Rating: **Bbb**

Bond Tenor: 7 years
Expiration: 2025

Industry: Banking

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Rating Rationale

Agusto & Co. hereby upgrades the rating of Wema Funding SPV Plc's ("the Issuer" or "the SPV") Series II ₦17.7 billion 7-year fixed rate bond ('the Issue' or 'the Bond') to '**Bbb+**'. The Issuer is a Special Purpose Vehicle (SPV) set up by Wema Bank Plc ("the Bank", "Wema Bank" or "the Sponsor") for the issuance of debt securities. The rating assigned to the bond is hinged on the Sponsor's upgraded rating of **'Bbb'** and is a notch higher given that 45% of the bond proceeds was invested in a 13.53% 7-year Federal Government of Nigeria (FGN) bond and held in the custody of the Joint Trustee. In the unlikely event of a default, this provides some recovery prospects. The upgrade in the rating assigned to Wema Bank ("the Sponsor") reflects its improving profitability metrics, satisfactory asset quality and liquidity profile. However, constraining these positive factors are the elevated operating cost profile, the harsh regulatory environment and prevailing macroeconomic headwinds.

Despite the challenging operating terrain which adversely impacts individuals and businesses, Wema Bank maintains its growth trajectory with total assets and contingents expanding by 13.1% to ₦1.4 trillion as at 30 June 2022. As at the same date, gross loans and advances stood at ₦465.1 billion, a 6.8% growth during the period under review. The Bank successfully recovered some impaired credits during the period under review, resulting in a 26.1% dip in non-performing loans (NPL) to ₦15.6 billion as at 30 June 2022. Consequently, the NPL ratio improved to 3.4% (FYE 2021: 4.9%), lower than the 5% regulatory maximum, and the cumulative loan loss provisions sufficiently covered the impaired loans by 152.9% (FYE 2021: 107.1%). In our view, active monitoring of the loan book is imperative to forestall any possible losses given the Sponsor's exposure to vulnerable sectors and heightened credit risk from a weak macro-climate.

In H1 2022, Wema Bank's net interest spread contracted to 46.7% (HI 2021: 56.9%) as the elevated yield environment and an increase in pricier term deposits moderated the impact of the higher interest income. Notwithstanding, the Sponsor's profitability was upheld by income from ancillary activities which rose by 29%, underpinned by the increase in electronic banking and account maintenance fees. Although the operating expenses pushed up by 26.6%, driven by inflationary pressures and higher regulatory costs, the Bank's cost to income ratio (CIR) improved to 81.1% (H1 2021: 82.9%) due to better earnings. Overall, the Sponsor's profitability strengthened, with annualised return on assets (ROA) of 0.9% (H1 2021: 0.8%) and annualised return on equity (ROE) of 18.6% (H1 2021: 14.7%). We view

Wema Bank's improved profitability positively. In the near term, we believe increased lending activities and uptick in digital transactions will uphold profitability. However, the raging inflationary pressures, stringent CRR regime and high funding costs will continue to threaten profitability.

In the half-year ended 30 June 2022, Wema Bank's growing brand franchise and digital footprint, particularly in the retail and SME market, propelled the deposit liabilities to cross the ₦1 trillion mark, to stand at ₦1.1 trillion, reflecting a 13.5% growth compared to FYE 2021. The Bank is a mid-tier bank with a good digital platform "ALAT" which has helped improve the image of Wema Bank amongst the budding youth. We believe that continuous investment in the Bank's digital platforms will continue to support deposit growth going forward.

As at 30 June 2022, the Sponsor's capitalisation levels remained just adequate for the level of risks undertaken with the capital adequacy ratio (CAR) of 11.9%. This was above the regulatory minimum for a national bank. In the near term, we anticipate an increase in capitalisation based on the ongoing ₦40 billion capital raising programme by the Bank.

Based on the aforementioned, we hereby attach a '***stable'*** outlook to the rating of Wema Funding SPV Plc's Series II ₦17.7 billion 7-year fixed rate bond.

Strengths

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

Weaknesses

- High cost-to-income ratio
- Concentration in the funding base
- Low market share

Challenges

- Fragile macro economic environment
- Impact of the raging inflationary pressures on operating costs
- Adverse regulatory climate
- Raising core capital in a period of investor apathy

Table 1: Background Information

	31 December 2020	31 December 2021	30 June 2022*
Total Assets & Contingents	₦1 trillion	₦1.2 trillion	₦1.4 trillion
Net Earnings	₦42.1 billion	₦56.6 billion	₦32.4 billion
Pre-tax Return on Average Assets & Contingents (ROA)	0.6%	1.1%	0.9%**
Pre-tax Return on Average Equity (ROE)	10.7%	20.3%	18.6%**

**Unaudited*
***Annualised*

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