Title: Union Bank of Nigeria 9M 2017 Investor and Analyst Conference Call

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Speakers: Emeka Emuwa and Oyinkan Adewale

Presentation

Operator

Hello, and welcome to the Union Bank of Nigeria Nine-Month 2017 Investor and Analyst Conference Call. Throughout the call, all participants will be in 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'm pleased to present Mr Emeka Emuwa, CEO. Please go ahead with your meeting.

Emeka Emuwa

Thank you very much, and good morning. Today, I have with me Mrs Oyinkan Adewale, who is our CFO; and Mr Kandolo Kasongo, our Chief Risk Officer. Welcome to this call, which is the last call for this year.

I'd like to just go straight to the operating environment, which is slide 8. The general message here is: notwithstanding some of the ups and downs we have recently seen, we are exiting a recession. From a macro perspective, Nigeria started to come out of the recession in Q2 of this year. We have since then had declining inflation, even though higher than pre-recession levels; oil prices have been volatile, but they've been directionally up. On the regulatory front, the foreign exchange front is certainly positive. Monetary policy remains tight, and consequently interest rates have remained high. On the socio-political front, the economic recovery and growth plan for 2017–2020 was released. However, delayed funding of the budget has impacted the progress in 2017, particularly on capital expenditure. On the consumer front, consumers remain under pressure; this is the outcome of the last three years of economic pressure. But what that has done is this shift directionally to the purchase of made-in-Nigeria goods. And we have, certainly from a consumer perspective, more tech-savvy customers, which is driving the rise of more efficient and service-oriented start-ups, which suggests that consumers are going to be more and more inclined to use self-service, as opposed to traditional service.

Slide 9 is basically a recap of what I've just said: out of recession, reserves are up on the back of increased oil production and oil prices, and the IEFX window has been quite functional.

I'll go straight to the Union Bank update because slide 10 has mostly been covered. And if you look at slide 13, which speaks about what we as a bank are focused on, it remains retail, trade and transaction banking. It doesn't mean we're not doing other things, but those are the three things that are the core of what we have been doing and are looking to do. We have a big focus on retail, and we are focused on trade and transaction banking across our commercial and corporate businesses. On the trade and retail side, it's our products and the channels. We want to make sure that we have predictable service delivery; we have partnerships that we want to make sure we enable; a very strong focus on customer acquisition, and we will talk a little bit more about that.

On the trade and transaction banking side, we want to be a leader in domestic trade. There's still international trade, but there's more and more focus on domestic trade while still focusing on service delivery and leveraging the value chain. And there's certain segments that we will continue to focus on. Some, such as agriculture, where we have deep expertise from the past, we continue to leverage that, and then other areas that are coming up. On top of that, efficiency and productivity are things that will form the basis of how we operate on an ongoing basis.

Across our businesses, the strategy is consistent i.e. across corporate, commercial and retail. On the corporate front, we want to be the key transacting partner for our strategic clients. On the portfolio side, we optimally defend our portfolio and continue to provide structured solutions and services to our clients. On the commercial side, we want consistent service across all channels, to provide solutions to specific sectors, and continue to deliver customised advice and support to sectors, whilst we leverage the value chain of growth to deepen our relationships. Now, value chain is across all segments but, as you see, commercial sits in between corporate and retail. On the retail front, a fully segmented retail business is what we are building and continue to build, focused on innovative deposit solutions, and continue to enhance our alternative channel features. That's the strategy across all fronts, and you'll see that there is consistency across all segments, because what we are trying to do and what we have been doing, is to leverage the different business segments and ensure that we capture all the opportunities across those segments.

As we have said in previous calls, if you look at slide 15, there are some priority areas that are important for us as a business: we're talking about people, capital, funding and liquidity, operational and cost efficiency, as well as the positioning of the bank. So, just a quick update as to where we are so far on those five fronts. We have invested in our people, and continue to do that to drive productivity; that is a focus, it is a theme you will continue to hear more and more from us as we close out 2017 and start going into 2018. Productivity is going to be a key point for us. We launched a revised employee value proposition, basically to drive retention, and we were ranked the ninth-best company to work for. So, basically making sure that we retain our people, train our people and, on that basis, get more productivity out of them.

On the capital front, the ₦50 billion rights issue closed a few days ago. There's still a process to go over the next few weeks, but we expect that by the end of 2017 that should be closed, and we have that funding in. We have also resolved the negative retained earnings constraint. We had the court-ordered meeting, and filed at the Corporate Affairs Commission. That will allow us to in future years, pay dividends. It would remove the technical constraint.

On the funding and liquidity side, we remain above regulatory requirements. We have secured incremental funding and trade lines and we will, on the back of the capital risk, continue to seek to leverage the balance sheet in an optimal manner.

On the cost front, we have made cost savings. What we have done with those cost savings is to reinvest them in technology and in process, and this speaks to the productivity that we will have more of. So, what we have saved is invested in things that will enable us to be more productive as we go out into the future. And we continue to increase the alternative channel push; again, that has dragged down our cost to serve, so we are moving customers into using alternative channels.

On the positioning front, we have done quite a bit in 2017. We launched a 'Clear Your Doubt' campaign, which has been yielding quite positive results; that was launched a few months ago. We reinforce the simpler, smarter bank through UnionMobile and UnionOnline. We have also had centenary celebrations across the country during 2017.

All that translates into a variety of outcomes. On slide 16, you see a summary of some of them. So, since we started this journey, we have had almost 62 times growth in active mobile banking users; we have almost 18 times growth in online banking users; transactions processed of over ₦80 billion; 11 times growth in active debit card users (up from 200,000 to 2.2 million); the number of ATMs is up by a factor of three; the number of POSs is up by a factor of six. So basically, that front is moving and moving quite well as far as our digital penetration goes, and that is something we expect to accelerate.

In 2017 also, we continued to make sure that the platform remained and continued to be more modern. We have transformed and upgraded a number of branches, and continued our community and sustainability efforts in 2017.

I talked a little bit about Union @ 100, which were our centenary celebrations throughout the year. They have been largely focused on the customers and the community, and inspiring discussions around the next 100. So, we have done 100 years, and we are basically preparing and prepared for the next 100. So, we have launched branches, we engaged customers, we engaged the communities on different fronts. Particularly, one area I'd like to call out is the Centenary Art Challenge, where we went across the country, invited artists of all ages, students and non-students, to basically interpret the stallion. We had a winner from there, and it basically resulted in a very high level of engagement from a different constituency than we otherwise would have, and the result also was that we had some pretty interesting pieces of art.

Now, our rights issue closed on 30th October. I said earlier on, by year-end we should have the proceeds in with everything done, but we still have a few processes to go through. We are confident, that we will raise the money that we sought to raise, and it will enhance our regulatory capital, increase our working capital and continue to invest in technology, digitalisation and customer touchpoints.

So, that's basically what we have done so far, how the third quarter is looking and how we are preparing to go into 2018. So, I'll hand over to Oyinkan Adewale, our CFO, to speak to the numbers.

Oyinkan Adewale
Good afternoon. I'll start from slide 21, which is the Group key financial highlights. Group earnings up 16% to just under ₦110 billion, from ₦95 billion last nine months. PBT at the Group level down by 2%, but this is only because we had a one-off in the 2016 numbers. Interest income up 22% to ₦88.5 billion, largely on the back of the growth in the loan book relating to 2016. Net interest income after impairment is up 16%, because impairment charge in 2017 is lower than in 2016. Non-interest income is down 6%, but this is only because we had non-recurring one-offs in 2016, largely the FX devaluation gain that we had recorded in Q2 of 2016. Customer deposits are up 17%, for the reasons that Emeka just went through. The loan book is down 5%; that disaggregates into the foreign currency loan book going down, but the local currency loan book up. We will go into that in greater detail as I go on.

Going to slide 22, which is the summary of the Group performance; loan book is down 5%; total assets up 8%; customer deposits are up 17%; net equity up 5%; loan-to-deposit ratio is down 15% as a consequence of the growth in the deposit book; non-performing loans ratio 9.1%. We will talk about that but important to note that the coverage ratio has improved to 202%, so we are very well covered as far as the NPL book is concerned. The rest of the page is pretty much a rehash of what we said earlier: earnings up 16%, interest income up 22%, non-interest income down 6% because of the one-offs we had in 2016, impairment charge down about 53%, operating expenses up by 10%, but we note that 10% is far lower than the rate of inflation, and it reflects the double-digit inflation in the economy and the general macro conditions under which we're operating. It's a lower rate of growth than the rate of growth of revenue. Net interest margin is down 1%, and this is largely a function of the increase in interest expense, and that tracks the general increase in Nigeria in interest rates, which itself tracks the increase in Treasury bill rates which banks have to match in order to retain deposits. ROE and ROA are both down because PAT is down. Net asset value per share: ₦16.86, which is ₦1.91 better than 2016. Earnings per share, ₦0.72, is slightly down relative to 2016 because PAT is down.

Going to slide 23, on the bank. Gross earnings up 14%, PBT down 11%, and that's largely, again, because of the one-offs that were in the 2016 numbers. Interest income is up 21%, and that reflects the increase in the size of the loan book from December 2016 to September 2017. Non-interest income is down 9%, and this reflects two things: the one-offs that were in the 2016 numbers and the fact that we are no longer making money from our Naira MasterCard as we were in 2016, because of the CBN's position on that. Customer deposits are up 20%, and Emeka took us through the factors responsible for that. The loan book down 6%, and in a minute, I'll show how that breaks down into the foreign currency loan book and the local currency loan book.

Going to slide 24, bank total assets up 11%; the bank loan book down 6%, and I'll get into that in detail in a minute. Customer deposits are up 20%. Liquidity ratio still very strong, still far above the minimum required 30% at almost 41% as at September 2017. Loan-to-deposit ratio is at 64%. In December, we were slightly above the CBN guidance of 80%; now we're at 64% because of the growth of the deposit book. Non-performing loan ratio is 9.6%, but coverage is at 202%. And the rest is not much different from what we had on the Group slide.

Going to slide 25, interest income has been a leading driver of revenue growth in the nine months to September 2017. Bank gross earnings are up 14%. Interest income up 21%, again a reflection of the increase in the size of the loan book from September 2016 to September 2017. Non-interest income down by 9%, but if we exclude the one-off FX gain of ₦4.7 billion which we earned in 2016, and about ₦0.75 billion gain on subsidiary sales, also in 2016, we actually recorded a 20% increase in non-interest income. After impairments, net interest income is up 13%. We have recorded ₦2 billion in recoveries in the nine months, which is again an improvement over the number that we showed at half year. The recovery engine continues to be productive. On the gross earnings, we show the composition of gross earnings and what you see in the nine months is that it's high-quality revenues; there are no episodic items included there. Going to interest income and interest expense: while interest income has increased, interest expense has also continued to increase, reflecting what is happening in the market generally, and therefore we have seen an interest margin compression. Between 2016 and 2017 it's gone down from 10% to 8.2%, entirely a reflection of the increase in interest expense. Non-interest income drop is attributable to the absence of one-offs in the 2017 number.

Going to slide 26: at the bank level, deposits have grown 20% to about ₦758 billion. We're happy to note that low-cost deposits have increased to 66% of total deposits, up from 65% at December. The growth in the deposit book is attributable to a rise in the number of customers, increased uptake of our product offerings, increased market penetration, and increased acceptance of the brand. We have seen a 90% year-on-year increase in new-to-bank customers. The number of our active mobile subscribers has grown by 103% year on year. The number of active online subscribers has grown by 148%. The number of active cards has grown by 38%. So, all the metrics are going in the right direction and are all resulting in customer deposit growth. Deposit by customer segment is not much different to the structure we have had historically: 62% is retail, 24% is commercial and 14% is corporate. Funding structure for the bank is largely funded from customer deposits, which account for 67%. Foreign currency borrowings account for 23%.

Going to slide 27, we continue to make deliberate efforts to maintain the balance of the loan book. As mentioned earlier, the loan book in total dropped by 6% on the back of improved FX availability, which enables us to liquidate mature obligations in the foreign currency loan book, leading to a 19% decrease in the foreign currency loan book relative to December 2016. On the other hand, the local currency loan book has gone up by 8%. We're also happy to note that the foreign currency loan book now stands at 44% of gross loans versus 51% at December 2016. So, we have rebalanced the loan book in terms of the composition, local currency versus foreign currency. We have also reduced concentration in the oil and gas sector, and the specific percentages can be seen in the chart at the bottom of that page. In terms of business segment distribution of the loan book, it is not much different from what we have reported historically: the corporate bank accounts for 72% of total loans, the commercial bank 23% and the retail bank 5%.

Going to slide 28: as I mentioned earlier, the coverage ratio is 202%, which reflects very adequate provisioning and mitigates the NPL ration of 9.6%. We remain focused on NPL recovery and continuous monitoring of the loan book. As I mentioned earlier, year-to-date 2017 we have recovered ₦2 billion in NPL, which is about 120% increase above ₦923 million which we did in 2016 nine months. We also show the non-performing loans by sector: again, not much different from what we have shown before, and the numbers are there in the chart. We also show at the bottom of that slide

NPL and coverage ratios, and important to note there that the coverage has continued to improve. In June, it was 185%; now, it's 202%.

Slide 29 in a nutshell shows that all the important metrics for the bank are trending in the right direction. Thank you very much.

Emeka Emuwa
Okay, thank you very much Oyinkan. So, looking ahead, if you go to slide 31, what are we looking at for the rest of the year, and on a longer-term basis? We are focused on being a leader in retail banking, trade and transaction banking; we want to be Nigeria's most reliable and trusted banking partner; we want to be a leader in citizenship, sustainability and innovation. So, we have a second objective which is business-related, but is at the heart of what we are; and obviously, we want to do things right. So, we operate in a certain environment and want to be part of that environment.

So, as we close out 2017, what we are doing is consolidating the gains and positioning for 2018 growth, because our focus now is going into 2018. All the actions and things we talked about a little bit earlier, we want to sustain them. We want to sustain our customer growth; it has been growing and we want to sustain and in fact, accelerate that as we go into 2018. We expect to close out 2017 with an enhanced capital profile, given the rights issue which has just closed. We expect to close 2017 with a strengthened brand, given all our positioning activities and the results that we have been seeing from the campaigns that we have run and from the feedback where we are getting from the market. So, we want to focus on that strengthened brand. And we want to make sure that our platforms, our channels, our people, our processes continue to be strengthened so that we can, in 2018 and going forward, have focus on productivity and growth. So, 2017 is to close out all the actions that we have talked about earlier on, and sustain them so that as we go into 2018, we are focused on growth and maximizing the opportunity and the productivity of the platform that we have.

We have identified a number of opportunities for growth. There are key sectors for Nigeria's growth, and we will invest in them. We will facilitate trade and transactions across those sectors and their value chains. We have a platform that we have built, and that platform is people, technology, and capital infrastructure, as well as the brand. The bank is the platform, and we're going to leverage that platform for productivity heading into 2018. We will continue to drive the retail proposition on SME, on lending, on digital. That will continue, and it will accelerate. We will continue to leverage partnerships for business growth and operational enhancement. There are growth opportunities and there are growth areas and we will continue to tap into those as we go into 2018.

I mentioned earlier on that productivity from people, from our balance sheet, our capital, our operational productivity, is expected to translate into further growth in terms of revenue and in terms of profitability as we go into 2018 and beyond. And even as we focus on revenue lines, another element is our focus on cost efficiencies. Those are the things that will enable us to achieve our financial objectives as we go into 2018 and beyond.

So, we believe that we are on track. We say we are simpler and smarter bank. We are well on track to reinforcing that, and if you look at slide 35, it basically shows the path that we have come through to get to that point. So, ladies and gentlemen, we will take any questions that you might have now. Thank you.

Q&A

Operator
Thank you. Ladies and gentlemen, if you do wish to ask a question please press 01 on your telephone keypad now. If you wish to withdraw your question, you may do so by pressing 02 to cancel. And there will be a brief pause whilst any questions are being registered.

And the first question comes from the line of Toyosi Oni from Renaissance Capital. Please go ahead, your line is now open.

Toyosi Oni
Hi, thank you very much for hosting this call. I have a few questions, please. The first question is on the reduction in CASA from June 2017 to September 2017: what happened here? Was it that clients just switched terms suddenly?

My second question is on your oil and gas percentage of the advances book. It's at 47%; you do note that this has declined. Are there any more plans to reduce it more meaningfully as a proportion of the book?

My third question is on your power NPLs. It's still 39% of the book; is there any timeline or amount vis-à-vis recovery or resolution on this?

And my fourth question is on an update on the results of the rights issue. Thank you.

Oyinkan Adewale
Could you please repeat questions one and two?

Toyosi Oni
Okay, so my first question was from the reduction in CASA from June 2017 to September 2017. I was wondering what happened here; was it that clients just switched suddenly to term?

And my second question was on your oil and gas advances, it's 47% of your advances book. It seems huge, and I was wondering if they were any plans to reduce it more meaningfully as a general proportion of the book?

Emeka Emuwa
Okay. So, the first question on –

Oyinkan Adewale
CASA, reduction in CASA.

Toyosi Oni
Yes, reduction in CASA.

Oyinkan Adewale
The oil and gas by the way, 47% is the December 2016 number, not the December 2017 number. It's actually come down. Are you with me?

Toyosi Oni
Yes, I am.

Oyinkan Adewale
Okay, yeah. So, it's actually come down by over 800bps. So, I think you misread the chart on the oil and gas.

Toyosi Oni
Okay. Well, it's still a bit high, so I was wondering if there were any plans to meaningfully reduce it going forward.

Emeka Emuwa
So, we have three questions there. You want to take the other questions? Yeah, let's take the other questions as well, then we can take them in groups. So, we have three – no, four questions there: oil and gas, CASA, NPLs, updates on rights issue. Okay? Fine. Alright, thanks. Next question?

We will answer this one, but then afterwards we will take questions in a group. Okay, on the oil and gas exposure, in absolute terms I don't believe that the numbers –the percentage has come down. If you look at our overall loan portfolio, it has come down a little bit. So, in terms of its significance within our overall portfolio, that has come down. Now, we talked earlier on about the opportunities that we are looking at, as we go into 2018 and 2019, and a number of those are in the non-oil sector. If you look at the direction of travel of the Nigerian economy, there is a bias towards non-oil. That is the direction that our loan book is being more focused on. So, as that happens, the significance of the loan portfolio in our overall portfolio will come down.

As far as the rights issue, there's not much we can say beyond that it is closed until we get formal communication back. You know that there is a process, and we have to go through that process; once that is concluded, we will be able to share the outcomes of that with yourselves. So unfortunately, we are constrained in what we are allowed to say vis-à-vis the rights issue. But it has closed, and from the indications we will have a positive outcome. This is just the indication from the roadshows that we went to, and when we engaged with investors and shareholders, there was an interest in picking up rights.

There was – reduction in CASA, and this was Q2 to Q3. Yeah, we're going to look at the full picture, and Q3 to Q4 the ebbs and flows in customer balances. So, what you should probably look at is, what the ratio of our low-cost deposits within the context of our overall portfolio is. And I believe that number has actually gone up to 66%.

What was the question on NPL?

Oyinkan Adewale
Power NPL.

Emeka Emuwa
Okay, the power NPL is just one exposure. Thank you.

Toyosi Oni
Okay, thank you sir.

Operator
Thank you. And our next question comes from the line of Kehinde Owonubi from WSTC Financial Services. Please go ahead, your line is now open.

Kehinde Owonubi
Thank you very much for the presentation. My first question is on the NPLs; I wanted to find out if you expect further recoveries before year-end, and if you have a guidance for your full-year 2017 NPL?

My second question is on your CAR, Capital Adequacy Ratio. I don't see the figure anywhere; I was wondering if you have it as at nine-month 2017? Thank you very much.

Emeka Emuwa
Okay. My earlier comment was around guidance, which is why I couldn't speak much around where we are on the rights issue, and part of that process was that until closed, there's only so much we can say in terms of guidance. So, when you talk about – your question was really about the NPLs, right? And the other question was on CAR. I think, as I said earlier, that we have given an indication of what it would look like at the end of the year, which is what we are focused on, given the rights issue. With regard to capital risk, we expect to do very comfortably in excess of the capital to be raised. We will be very comfortably in excess of regulatory capital requirements, and with a significant buffer, so by the end of the year that should be the case.

And on NPL, this question is about whether there will be further recoveries. For us, the recoveries are an ongoing process, so it's something that we keep on working on every day. And some days you get something, some days the focus is on getting as much as we can. And it's not just a year-end effort or initiative; it's an ongoing initiative.

Kehinde Owonubi
Thank you.

Operator
Thank you. Ladies and gentlemen, once again, if you do wish to ask a question please press 01 on your telephone keypad now. And if you do wish to withdraw your question at any time, you may do so by pressing 02 to cancel. There will be a brief pause whilst any further questions are being registered. And as there are no further questions, I will now hand the conference back to the speakers.

Emeka Emuwa
Thank you very much, ladies and gentlemen, for your time, and we will speak to you on the next call. Thank you.

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