Title: Union Bank of Nigeria Plc H1 2018 Investor & Analyst Conference Call

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Speakers: Emeka Emuwa and Oyinkansade Adewale

Presentation

Operator

Hello and welcome to the Union Bank of Nigeria PLC First Half 2018 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. And just to remind you this conference call is being recorded. Today I'm pleased to present Emeka Emuwa, the CEO of the Union Bank of Nigeria PLC. Please go ahead with your meeting.

Emeka Emuwa

Good afternoon, ladies and gentlemen. Welcome and thank you for joining us today. We'd just like to talk about the first half of the year. Let's go straight to the operating environment which we all know, on slides 7 and 8. Today, the environment we're in is one that has the future reasonably positive. We have declining interest rates, declining inflation, stability in oil prices and accelerating reserves. So we have started seeing some growth following the recessionary period, and macroeconomic trends largely positive. Notwithstanding that, we still have a tight monetary policy stance and nothing has changed on the MPR front in the last few meetings. We still have CRR, the MPR and liquidity ratios maintained at the same level.

One of the things that we have seen and we continue to see is that on the back of the recession, there is some restructuring in the economic environment, and there's an incremental focus on agriculture, manufacturing, SMEs - things that will increase domestic output and domestic supply - rather than imports. This is a measure of domestic import substitution. On the consumer front, one of the things that we see is an increase in the use of social media. We see consumer purchasing power declining somewhat, on the back of inflation.

The impact is that you find quite a few consumers trading down, and you also find companies doing well by following the consumers on the way down. So, I guess the only thing that is in the horizon outside of the positive macros, which you can see on slide 7 and slide 8, is the election. We are in election season. The one thing we believe is that no matter what happens in the run-up to the elections, once the elections are done, everybody goes back to the drawing board and we all carry on with our business. But there has been and will a bit of noise in the run-up. This is expected, as it has always happened. But post elections, we have all gone back to our business.

I will now update you on what we're doing. On Slide 10 is a recap of our journey so far, our transformation in 2016-2017 and then positioning for continued productivity and profitability in 2018. I think that's a section that I'd like to call out on slide 10 because our focus is on productivity and profitability. We have a platform that works, and what we're doing is making sure we extract more productivity out of that platform, with our infrastructure, our balance sheet, our people, and our customers. We're looking to leverage the platform to do more with them and that will translate into incremental profitability.

If you look at Slide 11, which is a recap on what our ambitions are, this is what informed our strategy. We want to be Nigeria's most reliable and trusted banking partner and we want to be a leader in retail and transaction banking. There are 198 million people transacting amongst themselves, amongst industries, amongst segments; we want to make sure that we are in the middle of as many of those transactions as possible. And while we do our business, we want to be a leader in citizenship, sustainability and innovation. One of the things that we're focusing on are the real opportunities aligned with Nigeria's growth. We've come out of recession, so there is growth.

What we're doing is focusing on the opportunities that are arising from that. We'll support the key growth sectors and the priority sectors, including agriculture, manufacturing, services, SMEs; those are areas that we believe have continued potential. We are an oil and gas nation, we recognise that. So, there will always be some activity in that area. But fundamentally, there are a number of areas that we're focused on. We continue to drive our retail proposition on the lending and on the digital front. We'll facilitate trade and transaction banking across value chains. I talked about the fact we have a large population transacting, that we want to be in the middle of these transactions, leveraging partnerships for business growth and operations. Central to what we are doing this year is harnessing the platform for productivity and profitability. And that platform consists of our people, technology, capital, infrastructure, and brand.

Slide 13 expands a little bit on leveraging the platform. We will drive the value chains within customer ecosystems. Whether it’s a regional customer, commercial customer, or corporate customer, we want to access as much of those ecosystems as possible, and that's what our platform was built to do. We want to drive low cost deposits for all our segments, deepen our client relationships, acquire high-quality new accounts, as well as continue to reactivate dormant accounts.

On people, it’s basically enhancing their competencies and skills. We want to continue to train and build our talent pool. As regards process and infrastructure, we continue to focus on bringing down our costs as well as implementing efficient and innovative solutions. We’re doing much more today with solar powered energy. We’ve introduced robotics that will enable us have more efficient processes. We find that we are able to execute some processes in much shorter time than human beings can, which allows our staff to be more productive and engage with customers more.

We continue to streamline our processes for productivity. We will continue to leverage technologies that we’ve invested in to enhance capacity so that we can scale up and increase the volume of transactions. We have been increasing transactions without increasing costs by the same measure. We continue to invest in innovative customer touch points and then in our partnerships. If you look at some of the productivity metrics that we’ve seen over the past year, you’ll see that in comparison to the same period last year, staff productivity is up 23%. Net revenue per staff is up, ATM availability is up, transaction volume is up 53%, and transaction value is up 38%. On the UnionOne front, we’re up 22% on value and 61% in volumes. As you can see, across key metrics we’re tracking, productivity is rising. We plan to maintain this momentum going forward.

Slide 15 - investments in the digital front are aligned with our retail and transaction banking focus. You can see that, relative to a year ago, we have double the number of active mobile users; four times the number of active online banking users, two times the value in monthly transactions on UnionOne. UnionOne is a corporate payments and collections platform. We have one and a half times the number of active debit cards, 1.2 times the number of active ATMs and 1.4 times the number of POS’ sold.

These all highlight our forward momentum. The platform that we have built continues to be leveraged. On slide 16, you can see what we’re doing on the cost side. This year, we have introduced robotic process automation into our ATM reconciliation process, the first of many processes. RPA speeds up the process, and we are able to complete it in 0.1% of the time it took a human being. This means that our people can spend more time engaging the customer in value-added services, instead of on processes which can be automated. Other cost optimisation initiatives include office space optimisation. We have the tallest building in West Africa with 26 floors. We will have freed up 11 or 12 floors by the time we’re finished with the office restacking, and we’ll either shut them down or lease them out.

On slide 17, we talked previously about the critical enablers that are key for our progress and we stay focused on them - attracting customers, managing risks, lowering our funding costs and ensuring that we have funding and liquidity to support increased customer activity. Our operational and cost efficiency, reducing our cost to serve and then leveraging innovation for efficiency, whilst continuing to invest in people, drive productivity in people, all this on the bedrock of technology. These are our critical growth enablers and we continue to see traction on them.

While we do our business, we’re also focused on driving impact in areas that are important to Nigeria’s growth. On the citizenship, sustainability and innovation front, there are a number of different initiatives that we’ve pursued, and you see those on slide 18.

Slide 19 summarises our financial performance of the last few years. In the first half of this year relative to the first half of last year, there’s been consistency in our financials and in our profitability. This has been the case over the last few years, and we see that continuing into the first half of this year.

We spent a few years on our transformation, and we believe it's successfully completed. The platform is built, it's working, and we're leveraging that more and more. That's why you find us focusing on productivity and profitability and you'll be hearing us speak to that more and more as we go forward.

I'll now hand over to Mr Adewale, our CFO, to take us through our H1 financial performance. Thank you.

Oyinkansade Adewale

Good afternoon everybody. On slide 21, we have the highlights of the group performance for H1 2018. Gross earnings were up 16% and this is the combination of the 10% increase in interest income and a 37% increase in non-interest income. On the interest income side, the numbers reflect an improvement in our net interest margin, which went up from 7.9% to 8.2%. For non- interest income, it's a combination of a number of things. We had a strong half year on the Treasury side in fixed income trading. We had pretty good numbers in NPL recoveries. Our alternate channel revenues went up by over 300%, all this leading to a 23% increase in profit before tax, which is supported by the 16% increase in gross earnings and also a reduction in cost of funds.

Our customer deposit book was up 3% relative to December 2017. That splits into a 66% increase in foreign currency deposits, combined with a deliberate selective paying down of expensive deposits which we did in quarter one of this year. The loan book relative to December 2017 is down 9%, and that reflects our successful collection efforts on the NPL side. It also reflects a write-off of about NGN64 billion in mostly legacy non-performing loans, which we had fully provisioned over time. We wrote off about NGN64 billion and that largely accounts for the drop in the loan book. The bank remains very amply capitalised with capital adequacy ratio at 18.2% at the end of June, versus a minimum requirement of 15%.

Going to slide 22, we talked about the loan book down 9% and deposits up 3%. We're happy to report that we have virtually halved the NPL ratio. At the end of 2017 it was 19.8%. We have brought it down to 10.8% by resolving the large chunky NPL that we ended the year with. The last time we spoke, we gave a guidance of sub 12%. We've actually bettered that at 10.8%. The bank remains very liquid, with liquidity ratio at 38.5% at the end of H1 compared to 37.4% at the end of December.

Our cost to income ratio at 72% reflects a number of things, such as one or two one-off items which will not recur in H2. And also we've seen a 25% spike in NDIC and AMCON levies relative to the previous half year. Our ROE is at 6.7%, ROA at 1.5% and net asset value per share is almost NGN10, and earnings per share is NGN0.35 for H1 2018. Going to the next slide, we'd like to call out cost of funds there. Our cost of funds for H1 2018 have come down to 5.7% relative to H1 2017 when it was 6.1%. Net interest margin has gone up to 8.2% versus 7.9% in H1 2017.

Going to slide 24, our funding structure continues to improve. Low cost deposits at the end of June constitute 70% of total deposits, versus 65% at the end of December 2016 and 67% at the end of December 2017. As regards our funding structure, the bank is still funded largely from customer deposits; with the customer deposits accounting for 65% at the end of June 2018. In terms of the business segment split, the retail business accounted for 52% of deposits at the end of June 2018.

On slide 25; at the end of June, our foreign currency loan book had come down to NGN236 billion from NGN260billion at the end of December, and the proportionate share has also come down. The June NGN236 billion accounts for 46% of the loan book. In terms of the business segment split of the loan book, 74% of the loans are in the corporate segment with the retail segment accounting for 6% of the loan book.

Going to slide 26, we see a snapshot of a loan portfolio. As Emeka said earlier, Nigeria is an oil and gas economy. So, we can't run away from oil and gas. At the end of June 2018, oil and gas accounted for 45% of the loan book. Going to the NPL, we have more than halved the NPL book from NGN110.7 billion at December 2017 to under NGN49 billion at the end of June. And we have eliminated the real estate NPL which accounted for 32% of the NPL book at the end of December 2017; that has been resolved. And the NPL ratio is at 10.8% in June compared to 19.8% at December 2017.

Going to slide 27, as we set about rebuilding the loan book, having experienced a 9% drop in H1. We are focusing on a number of segments; segments which align with Nigeria's ERGP and segments which speak to the urgent need to replace imported consumption with locally made goods and services. We're focusing on consumer goods, on agriculture, agro-processing, services such as education and health, transportation, manufacturing and SME. As we said earlier, NPL is at 10.8%, down from 19.8% at December year end, and we continue to focus on recovering as much as we can of the NPL. Our 2018 guidance of the NPL ratio is sub-10%. Thank you.

Emeka Emuwa

Okay, thank you. On Slide 29, you see our guidance for the rest of the year. Most of these indicators were given earlier in the year. And we believe that we're largely on track on virtually all the parameters. On the loan growth, if you adjust for the write-offs that we did in the earlier part of the year, plus the large recoveries, we would otherwise be on track. But we do recognise that we intentionally did bring down the loan book. Deposit growth, also largely on track. The NPL ratio - we had the previous guidance of sub 12%. We've brought it down as of now to under 11%. Our objective is to continue to bring it down during the course of the year. So, the guidance is sub 10%. All the other indicators remain unchanged and we're on track.
And I think this is the good time to pause and take questions as they arise. Thank you.

Q&A

Operator

Thank you very much. If you do wish to ask a question, please press 01 on your telephone keypads. If you wish to withdraw your question, you may do so by pressing 02 to cancel. There will now be a brief pause while questions are being registered. And our first question comes from the line of Michael Oyeleye of Stanbic IBTC. Please go ahead, your line is now open.

Michael Oyeleye

Hello, thank you very much for the presentation. My question relates to the announcement about the AMCON fee, about the fund that the CBN will begin to enforce besides of the contingent aspect of the assets, as part of the AMCON fees. So, I just want to ask, what impact is that going to have on the Union Bank results in the coming years? What is the projected impacts for the closing AMCON fee?

Emeka Emuwa

Yes, this is an announcement that is under review. Once we have all the data as to how it's going to work, then it will give a sense of the impact. But the reality is that it will be what it will be. Our own objective is to stay focused on bringing down overall costs. The AMCON cost is not entirely within our control. So, we focus on the ones that are within our control and when we get all the modalities on that, then we'll be able to share with you what the impact will be.

Michael Oyeleye

Thank you very much.

Operator

Thank you. Our next question comes on the line of Ian Lapey of Moerus Capital. Please go ahead, your line is now open.

Ian Lapey

Hello, thanks for doing the call. Two questions related – one is why did you change this quarter, the accounting for your shareholding in Africa Finance Corp, the fair value through the P&L from – it had previously been fair value through OCI. And then related to that, it looks like this quarter you also reversed provision for unquoted equities; just any explanation on that would be appreciated. Thank you.

Oyinkansade Adewale

We adopted IFRS 9, and under IFRS 9, first time adoption rule, there are certain accounting entries you can recognise. So, the AFC treatment fully reflects that.

Ian Lapey

Okay. But didn't you adopt IFRS 9 as of 1st January? It looks like you made this change this quarter, not in the beginning of the year.

Oyinkansade Adewale

Exactly 1st January.

Ian Lapey

Okay. Yeah, it looks in your IFRS – excuse me?

Operator
Please continue.

Ian Lapey
Okay. No, it looks as if this change was this quarter, the quarter ended 30th June, whereas you adopted IFRS 1st January. So, that was my question. There had been, as of 31st March, a $5 billion provision for unquoted equities and that seems to have gone away as of June 30th.

Oyinkansade Adewale
We can take it offline. Please email your question to us

Ian Lapey
That would be great, thank you.

Operator
Thank you. Just to remind everyone, if you would like to ask a question, please press 01 on your telephone keypads. You can press 02 at any time to cancel. And there will now be a further pause while questions are being registered. And our next question comes from the line of Oise Ajayi of Meristem Securities. Please go ahead, your line is now open.

Oise Ajayi
[Inaudible]. My question is [inaudible].

Operator
I'm afraid we cannot hear you Oise. If I could ask you to try hanging up and redialling again so that we can get a better line from you. In which case, we will move to our next question from the line of Michael Akinyemi of Standard Chartered. Please go ahead Michael, your line is now open.

Michael Akinyemi
Thank you for the presentation. Just a quick question from the NPL [inaudible] sector. I noticed that the NPL for the [inaudible]. Thank you.

Emeka Emuwa
So, if we heard you right, you said the NPL on power and energy went up in absolute terms –is that the question?

Michael Akinyemi
Yes, you're right.

Emeka Emuwa
The names have not changed. It's essentially – we have the same names in there. There might be some element of interest that would be what increased the cost, but– there's no material change in either names or exposure.

Michael Akinyemi
Okay. How about the prospects of recoveries at the end of the year?

Emeka Emuwa
We've been focused on recoveries right from beginning of the year. We recovered one large one which was in the real estate. And so, we're still focused on recoveries– whether it's power, oil and gas, or other NPLs. We'll see how the rest of the year goes.

Michael Akinyemi
Okay, thank you.

Operator

Thank you. Again just to remind everyone, if you would like to ask a question, please press 01 on your telephone keypads now. And we have the line again for Oise Ajayi of Meristem Securities. Please go ahead, your line is now open.

Oise Ajayi

Good afternoon. A question on your retained earnings.

Oyinkansade Adewale

Okay. Last year, we went through a court-sanctioned capital reduction process which allowed us to utilise the positive balance on our share premium account to resolve the negative retained earnings. And this year, we’ve seen some accretion of earnings. That's how we did it. Thank you.

Operator

Thank you. And it seems we have no further questions. So, could I hand back to the speakers of a closing comments?

Emeka Emuwa

Well, thank you very much ladies and gentlemen for attending the call and we look forward to the next time we have an opportunity to speak. Thank you very much. Goodbye.

Operator

This now concludes our call. Thank you for attending. Participants, you may disconnect your lines.