Canadian Western Bank's (CBWBF) CEO Chris Fowler on Q2 2017 Results - Earnings Call Transcript

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Q2: 06-01-17 Earnings Summary

- *News*

EPS of $0.59
Revenue of $172.44M (+ 5.3% Y/Y)

Canadian Western Bank (OTCPK:CBWBF) Q2 2017 Earnings Conference Call June 1, 2017 2:00 PM ET

Executives

Matt Evans - AVP of IR

Chris Fowler - President & CEO

Carolyn Graham - EVP & CFO

Analysts

Gabriel Dechaine - National Bank

Sumit Malhotra - Scotia Capital

Robert Sedran - CIBC Capital Markets

Doug Young - Desjardins Capital Markets

Lemar Persaud - TD Securities

Sohrab Movahedi - BMO Capital Markets

Operator

Good day ladies and gentlemen, and welcome to the Canadian Western Bank Second Quarter 2017 Financial Results Conference Call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Mr. Matt Evans, Head of Investor Relations of CWB Financial Group. Sir, you may begin.

Matt Evans

Thank you. Good afternoon and welcome to CWB Financial Group 2017 second quarter financial results conference call. Presenting to you today is Chris Fowler, our President and Chief Executive Officer; and Carolyn Graham, our Executive Vice President and Chief Financial Officer. Also with us today are the other members of CWB's Executive Committee; Kelly Blackett, Glen Eastwood, Darrell Jones, Stephen Murphy, and Bogie Ozdemir.

Before we begin, please note that the conference call graphs, quarterly results news release, and supplemental financial report are all available on our Investor Relations website at cwb.com. Let me also remind you that our call today may include forward-looking statements and is possible, that actual results may differ materially from these statements. Our forward-looking statements advisory is found on Slide 14 and the agenda for today's call is on the second slide.

I'll now turn the call over to Chris.

Chris Fowler

Thanks, Matt. I'll begin with our second quarter performance highlights and a few comments on the continued execution of our strategy. Carolyn will follow the detail on our financial results before we move on to question-and-answer period.

Moving to Slide 3, this morning we reported strong second quarter results and continued success in executing our balanced growth strategy. Highlights this quarter include very strong annual earnings growth, positive loan growth and strong growth of stable relationship based branch-raised deposits. We continue to support our solid operating performance with a very strong capital position and credit quality remains stable with loan impairments and provisions for credit losses consistent with expectations.

Now turning to the continued execution of our strategy; our objectives are clear and we continue to execute. CWB's core purpose is to deliver unique full service commercial and personal banking experiences to business owners. We are strategically diversifying outside of Western Canada to significantly expand our addressable market without compromising the competitive advantage conferred through our focused approach. While purposeful expansion is important for our strategy, personal relationships tied to our network of 42 branches continue to represent the heart of our business. Today we are working to broaden these relationships with the help of our new core banking system. In May we celebrated the one year anniversary of our Go Live on the new system. I'm pleased to report, we are starting to realize the strategic benefits of this transformative advancement as we make steady progress towards both, improved client experiences and enhanced capital management.

As it relates to our client value proposition, this quarter we improved our digital banking experience through strategic enhancements through CWB direct online banking. The update provides a more consistent experience across our digital platforms and compliments new financial and communication tools within our mobile banking app. We also renewed our processing agreement with our card issuance partner and will soon offer TAP enabled debit cards. This quarter we launched Motive Financial, a new brand for CWB's online bank with a focus on creating valuable savings opportunities for clients from coast-to-coast. And the May 1 release of CWB PayHQ represents addition of a fully integrated omni-channel payment technology platform to our growing portfolio of business services products; and another step forward to enhance CWB's full service banking experience with business owners.

Together we expect these initiatives to improve the convenience and overall user experience of our business and personal banking tools and support development of the new and broader full service client relationships. The new banking system is a crucial enabler of our planned transition to the advanced approach for credit risk management and regulatory capital management. Transition to the advanced approach supports our capital management goals as we seek to level the playing field with our large bank competitors.

Let's move now to performance against our balanced growth objectives for loan. It's clear that sentiment has started to improve following two years of recession in Alberta and Saskatchewan; and I'm pleased to report that our lending businesses are performing well across the board. In fact, we delivered positive growth on a sequential basis within every products. The bar graph on Slide 4 demonstrates the continued progress we've made over the past year against the geographic diversification objectives. Our acquisitions together with strong performance from our businesses in Ontario contributed to a notable 42% increase in CWB's Ontario-based lending exposures over the past year.

As shown on Slide 5, strong 10% year-over-year growth of general commercial loans has also contributed to strategic industry diversification. General commercial loans now comprise 25% of our overall portfolio compared to 19% last year. Going forward, we will continue to pursue opportunities to service good companies with strong management operating within our targeted industry segments across the country. Slide 5 also demonstrates success against our funding diversification strategy. Targeted growth of business and personal deposits raised through our branches remains a key focus. In addition to being lower cost, these products strengthen relationships by providing clients with tools they need to manage their finances. Second quarter branch-raised deposits were up 9% from the same period last year including very strong 15% growth of lower cost demand in those deposits.

Now before I turn the call over to Carolyn, I'll take a moment to address recent developments within the alternative lending space of the Canadian housing market. Recent publicity related to challenges faced by CWB Optimum Mortgages largest competitor has resulted in both higher than normal mortgage application volumes for Optimum and increased deposit pricing within appropriate deposit funding channel. I want to be very clear that these developments have not disrupted our operations in anyway. For CWB it's business as usual.

It's important to note as shown on Slide 6 that term deposits raised through the broker network represented 34% of our total funding at quarter end, down from 38% last year, this change is a direct result of our balanced growth strategy. As I mentioned a moment ago, our strategic focus is to increase relationship based branch-raised deposits with particular emphasis on lower cost demand and notice deposits. Branch-raised deposits increased to 57% of total deposits this quarter, up from 53% last year. Demand in notice deposits now comprise 39% of total deposits, up from 34% one year ago.

Consistent with our funding plan, total broker deposits outstanding declined sequentially. The broker deposit network remains an efficient source for raising insured fixed term regional deposits and is proven to be a reliable and effective way to supplement core funding over wide geographic base. The deposits we raised through this funding channel are fixed term deposits with term maturities between one and five years; we do not offer a high interest savings account product.

Slide 7 highlights our deposit mix in dollar terms and the maturity profile of our total deposits, both branch and broker based. I will note that nearly 60% of our broker term deposits are maturities longer than one year. As we move through our third quarter, the broker deposit market remains deep, liquid and just as accessible as ever to CWB. I would emphasize that the weighted average cost of funding for broker deposits issued by CWB across all maturities in May 2017 was lower than in the same month in both of the last two years despite the impact of the recent price disruption. This partly reflects the fact that the broker deposit pricing was relatively low prior to the recent market turbulence.

From a mortgage origination and pricing perspective, the recent turbulence has resulted in higher than normal mortgage application volumes for CWB Optimum Mortgage, an incrementally higher market yields on newly originated mortgages. CWB Optimum has been a strong contributor to our recent growth and all 10 mortgages now represent about 10% of our overall loan portfolio. As we said before, we focus on good quality borrowers in this segment; our risk appetite is conservative and we're disciplined in focusing on the borrower's ability to pay.

Optimum's business model targets affordably priced homes with an average loan-to-value at initial funding of 68% this quarter on an average origination of $337,000. The average size of each outstanding mortgage is $231,000. At more than half the total [indiscernible] represents the largest geographic exposure within Optimum's portfolio followed by Alberta at 21% and D.C. at 17%. We assess markets by postal code and continue to actively adjust our maximum loan to value criteria based on local conditions. In recognition of risks within relatively expensive markets like Vancouver and Toronto, Optimum has selectively adjusted available loan-to-value ratios for residential mortgages.

In general, we require larger down payments on more expensive homes to manage our exposure. This portfolio has performed very well for us since we started the business in 2004 and we expect it to continue to deliver strong results. As we consider the increased volume of applications we're seeing, our manual adjudication and underwriting processes remain consistent with our conservative risk appetite and we continue to be very selective in approving new loans. We expect the recent market turbulence [indiscernible].

CWB Financial Group is performing very well as we head into the second half of the year. Loan growth is picking up across the portfolio and we continue to execute on our strategy. Going forward, we expect to capitalize on both, our broader reach and our ongoing transformation of the financial services landscape. Our approach will increasingly leverage our technology investments and related initiatives to deliver exceptional client experiences.

Overtime, we expect to build new full banking relationships in targeted markets both within and beyond our branch footprint.

I'm pleased with our strong performance so far this year and confident that CWBs dedicated caring teams across the organization are excited about the future and ready to help clients grow.

With that I'll turn the call over to Carolyn.

Carolyn Graham

Thanks, Chris and good afternoon. CWB Financial Group delivered a strong second quarter with a 4% increase in pre-tax, pre-provision income compared to last year and 48% growth in common shareholders net income to $48 million. The significant increase in net income was driven by a 67% decline in the provision for credit losses, primarily reflecting the impact of specific allowances recorded against energy loans last year.

Annual growth of total revenues was 5% comprised of 5% increases in both net interest and non-interest income. Net interest income benefited from a 7% increase in average loan balances and an 8 basis point improvement in net interest margin to 2.55%. Higher net interest margin partly reflects our improved funding mix including the benefit of very strong 15% growth of lower cost branch-raised demand and notice deposits. Higher non-interest income resulted from growth of wealth management fees, credit related fee income and higher net gains on securities. These factors were partially offset within common shareholders net income by increased non-interest expenses, acquisition related fair value changes and higher preferred share dividends.

While non-interest expenses were up 7%, strong cost control continues across the group. The $2 million increase in premises and equipment expenses primarily relates to the new core banking systems which went live at beginning of the third quarter last year. While CWB Maxium and CWB Franchise Finance which we acquired last year accounted for three quarters of the $2 million increase in salaries and benefits.

Diluted earnings per common share of CAD0.54 and adjusted cash earnings per common share of CAD0.59 were up 35% and 44% respectively with growth driven by the factors I've just mentioned partially offset by the July 2016 issuance of common shares. On a year-to-date basis pre-tax, pre-provision income of $186 million was 8% higher and common shareholders net income of $97 million was up 15% from last year; both metrics benefited from a 7% increase in net interest income and 17% higher non-interest income. The higher growth rate in common shareholders net income as compared to pre-tax, pre-provision income reflects a 42% decrease in the provision for credit losses.

Higher net interest income reflects 7% growth of average loan balances and a 4 basis point increase in net interest margin. Growth of non-interest income was primarily attributable to net gains on securities compared to net losses last year, 19% higher credit related fees and a 20% increase in wealth management fees. These factors were partially offset within common shareholders net income by growth of non-interest expenses, acquisition-related fair value changes and higher preferred share dividends. Diluted earnings per common share and adjusted cash earnings per common share of CAD1.10 and CAD1.20 respectively were up 6% and 12% from last year.

Second quarter net interest margin of 255 was up 8 basis points from both the same quarter last year and the prior quarter. Compared to last year, sustained favorable changes in funding mix and lower average balances of cash and securities positively impacted net interest margin. Our funding mix continued to shift towards lower cost relationship based branch-raised deposits with very strong 15% growth in the demand and notice category. Decreased utilization of higher cost broker storage term deposits, and this shares redemption of two higher cost non-NBCC regulatory capital instruments.

Year-to-date net interest margin increased 4 basis points to 251, mainly due to the changes in funding mix I've already discussed. While competitive factors continue to impact loan yields, the growing contributions from the relatively higher yielding CWB Maxium portfolio and contributions of CWB

Franchise Finance acquired last July helps to mitigate net interest margin pressure and higher yield on new yield was in CWB Optimum Mortgage will also likely support incremental support over the near-term.

At the same time the favorable changes in funding mix which have supported net interest margin to the first half of 2017 are expected to be less apparent over the next six months. This is mainly due to expectations for loan growth to accelerate in the third and fourth quarters which will likely require increased funding to the relatively higher cost to broker deposit funding channel compared to the first half of the year. We also expect to hold sequentially higher average balances of cash and securities with a lower average yield to the second half of the year; and in view of these factors, incremental net interest margin pressure is likely to reappear.

The second quarter efficiency ratio was 47.5%, up from 46.7% last year while the year-to-date efficiency ratio was stable at 46.8%. Operating leverage over the past 12 months was negative 2% while on a year-to-date basis, operating leverage was flat. We remain committed to discipline control of all discretionary expenses. Recent increases to our cost base reflects both strategic investment in technology to support exceptional client experiences and acquisitions to expand our addressable markets. We fully expect these investments to drive future revenue growth and contribute to positive operating leverage over the medium-term.

Turning to Slide 11; overall credit quality remains consistent with our expectations and reflects CWB's secured lending business model, disciplined underwriting practices and proactive man-management. The second quarter provision for credit losses was 25 basis points of average loans; this was down from 78 basis points in the same period last year and 27 basis points last quarter. On a year-to-date basis, provision for credit losses was 26 basis points, up from 48 basis points a year ago; abnormally high second quarter and year-to-date provisions last year reflected specific allowances related to energy loans as we took a proactive approach to resolve positions within our small portfolio of loans to oil and gas producers.

We've reduced the balance of this portfolio by $176 million in the past year and it now represents less than 1% of our total loans. We do not expect material credit impacts related to our remaining energy loans going forward and we now expect the full year provision to remain at the low end of our range between 25 and 35 basis points.

Slide 12 shows the level of gross impaired loans at April 30. Gross impaired loans totaled $138 million and represented 62 basis points of total loans compared to $145 million or 68 basis points last year, and $124 million or 57 basis points last quarter. While Alberta based loans represent 35% of our overall loan portfolio, impaired loans within Alberta account for 47% of total impairments. This percentage share was down from 55% last year and up from 41% in the prior quarter. The level of gross impaired loans fluctuate as new impairments are identified and existing impaired loans are either resolved or written-off; and does not directly reflect the dollar value of expected write-offs given our tangible security held in supportive of lending exposures. We review the entire loan portfolio to provide early identification of potential adverse trends with impairment decisions taken on a case-by-case basis.

Realization plans for impaired loans are monitored closely by a specialized team. Specific allowances for potential write-offs are conservatively established through detailed analysis of both, the overall quality and marketability of security held against each impaired account. Within total specific allowances of $18.3 million this quarter, our specific allowances of $4.5 million on loans with Alberta-based security, and that's down from $34.8 million last year and $5.1 million last quarter. The unusually high specific allowances last year were primarily related to energy loans.

Looking forward we continue to proactively monitor all accounts as well as developments within the residential housing sector. With the exception of the Greater Toronto area and certain parts in Greater Vancouver, Canadian residential loan real estate markets remain affordable. A material increase in the supply of homes for sale has recently become apparent within Greater Toronto and the surrounding area as sellers react to the Ontario Fair Housing

Plan. A moderate decline in the value of higher priced homes in these markets is evident in the last 30 days and consensus indicates market conditions maybe trend a more balanced state. Within the lower Mainland and Metro Vancouver, a general supply shortage of detached single family homes remains apparent and home prices have held relatively firm.

Chris already discussed our present and residential mortgage lending through CWB Optimum Mortgage. We also participate in the housing market activity through residential project financing and I will reiterate that our portfolio of real estate project loans across all provinces is strong and well structured. Our loan funding structure requires strong presales supported by non-refundable deposits and these factors reduce our loss potential in the event of presale recessions. We continue to see successful projects completed on-time resulting in full repayment and ongoing monitoring of all in progress projects confirm there has been no material evidence of account deterioration.

In general, we remain comfortable with our overall exposure to the housing market. The protection inherent in our secured lending business model and our proactive approach to loan management.

Slide 13 shows our very strong capital ratios at January 31. Using the standardized approach for calculating risk-weighted assets, our common equity Tier-1 ratio was 9.6%. Tier-1 ratio was 10.9% and our total ratio was 12.7%. At 8.4%, our three leverage ratio remains very conservative. The increase in CWB Step-One capital ratio from last year was driven by both earnings growth and the common share issuance in July 2016. We redeemed all $75 million outstanding 5.571% non-NVC subordinated debentures on March 22 which reduced the total capital ratio by approximately 40 basis points this quarter. Going forward, all capital levels will remain strong.

Yesterday our board declared a quarterly cash dividend of $0.23 per common share consistent with last year and the prior quarter. Common share dividend increases are evaluated every quarter against the dividend payout ratio target of approximately 30%. The first quarter dividend payout ratio was approximately 42%.

And with that I'll turn it over to Matt to begin the question-and-answer session.

Matt Evans

Thank you, Carolyn. This concludes our formal presentation for today's call and I'll ask the operator to begin the question-and-answer period.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Gabriel Dechaine with National Bank. Your line is now open.

Gabriel Dechaine

Good afternoon. Let's go on into this Opti Mortgage discussion and you did allude to some of the trends that you're seeing or you talked about some of the trends you're seeing with increased applications volumes. I was at the end of April, what do you think had they or was the commentary about the current quarter; what do you think today -- what are your approval ratio of those new applications and you know, is this going to accelerate your progress towards $4 billion of Opti Mortgages by 2019 I believe?

Chris Fowler

So the increase in the origination volume is continuing, it's not quite as high as it was when the challenge first occurred but we are proceeding with the underwriting in the manner we always have, we take it loan by loan, we validate the income, confirm the property and move forward. So we are not looking, we're not changing the manner under which we approve and determine which loans did I book.

Carolyn Graham

And the $4 billion target is a five-year outlook, so out to 2021, 2022.

Gabriel Dechaine

Great. So you mentioned that you might have seen a temporary blip, so we might see in Q3 a little spike in mortgages but from the sounds of it, it's kind of normalizing now or…

Chris Fowler

It's still up compared to historical volume for share. Again, our goal is to manage that loan quality in the manner that we have historically maintained a good solid portfolio and managed our risk appetite within our total exposure, not to change that dramatically.

Gabriel Dechaine

Are you rejecting more than you normally do because these are the -- the app volume is up; maybe some are what you normally see?

Chris Fowler

You know, I don't have that stat of sort of what that look to book is on it. I know that we have -- you know, we certainly follow our standard, we've got a process internal of how we adjudicate and take on the risk we're going to take on. And again, we have a capacity -- these loans are -- as I say adjudicated one by one; we can't take on a lot of extra volume with the current staffing that we have in that group. So we are seeing more so, it would absolutely give us the opportunity to be approving more of the better risk-rated loans than the higher risk-rated loans because we just have to pick a selection.

Gabriel Dechaine

Okay. And then the -- you talked about higher cost than the broker channel, and I've noticed a bit of a pickup in your JIC rates. From the one to five year duration in those buckets; I'm just wondering why are you -- your cost don't seem to be that far off, some of the players that we hear about in this market, not the main one obviously but some of the others, when do you have some sort of pricing advantage given you're much more diversified player, you're capital levels are very strong, you're not a model line essentially; I'm just wondering why you don't have some sort of funding cost advantage?

Carolyn Graham

I think the cost in that broker market were quite low going into the middle of April and have come up since then. We looked to access that market in accordance with our funding plan which just looks at our projected loan funding -- projected growth in our branch-raised deposits and then the balance between the two, we fund to the broker market. So for us the amount we're looking to raise dictates then where we choose to be in the list of that values on the -- that is posted in the broker market. So it's driven from our funding plan primarily.

Gabriel Dechaine

Okay. And my last question is on the liquidity commentary and I appreciate that. I was wondering what the -- what drove the liquidity ratio down? So if I look at the cash and securities; the total learning assets were sub-10%, it's not dipped below 10% than just going back -- way back in my model here; I've never seen that. Why did you bring liquidity down? And then, how much more liquidity will you be adding on, like is there a target ratio you look to achieve?

Carolyn Graham

So in thinking about average cash and securities as a percentage of the overall balance sheet. That's an effective way, that's a way to assess the overall proportion and perhaps the impact it will have on them; but isn't how we actively manage the cash and securities or liquid asset portfolio, that's a function of what assets you hold that qualify us high quality liquid assets and the projections of your loan inflows and outflows as we manage our liquidity. So we were managing a little bit lower in the third quarter and we expect to return to more normal levels moving forward.

Gabriel Dechaine

So there is no target ratio?

Carolyn Graham

No.

Gabriel Dechaine

And then what was that drop in liquidity; what -- why did you bring it down and what was the impact on the margin?

Carolyn Graham

It was just part of our active management as we look forward and contemplate our funding plan. Impacts on margin would have been a couple of basis points.

Gabriel Dechaine

Okay. Alright, thank you. I'll re-queue if I need to.

Operator

Thank you. And our next question comes from Sumit Malhotra with Scotia Capital. Your line is now open.

Sumit Malhotra

Thanks. Good afternoon. I'm going to pick it up on the same track. Just looking at that margin calculation and I'm sure everybody has their own numbers not as good as yours obviously, but I see on a sequential basis, it looks like the average yield on a loan portfolio was lower and it looks like that decline was more significant than the decline in your deposit costs.

So isn't the liquidity reduction driving the bulk of the NIM expansion of the quarter trailing, I think it would have been more than just a couple basis points. To me it looked like it was it was almost all of it.

Carolyn Graham

I don't have almost all of it, I have part of it. So that asset mix composition is also funding mix from the stronger growth in the branch-raised deposit and then you have all of the small puts and takes on your deposit costs because the myriad of issues that factor into the NIM.

Sumit Malhotra

So versus the 2.55 level and you've been helpful with this because of those puts and takes versus that 2.55 level, what in your view is a reasonable level for the back half of the year. Do we go back to the Q1 mark or is it going to be better than that?

Carolyn Graham

We'd be comfortable in and around the Q1 and I think 2.55 is not where we will see in the back end of the year.

Sumit Malhotra

And then let me tie in the mortgage part of it as well. Chris, you gave some comments to the press last month that while your interest in growing the optimum business is clear. You are unlikely to be in a position or you wouldn't be looking to acquire the overall business. As far as Alt-A is concerned a lot of business is coming your way, it sounds like organically is that the only way you are going to grow this business of would you consider acquisitions of portfolios from some of your competitors that may not be able to fund themselves quite as easily anymore?

Chris Fowler

Our focus on the Alt-A is to grow it organically and because we want to underwrite every loan itself and if there's other books of business that made sense for us we're interested we have bought portfolios historically in all of our different lines of business. I'm going to all take a side we are absolutely looking to underwrite those ourselves.

Sumit Malhotra

Acquisition in any form or portfolio type acquisitions nothing sounds like you said it in that regard.

Chris Fowler

No.

Sumit Malhotra

And then lastly for me, I think we or certainly I understand that mortgages may, this quarter anyway comprised a larger proportion of the overall loan growth and that may be the case near term. It was good to see the commercial book start to come back as well and certainly we saw the growth across provinces, which hasn't been the case in the last few quarters. When we look specifically at your general commercial portfolio which truly been the source of strength for this company historically, are you starting to see some of your traditional sectors and customer base work through the challenges in last few years and your commentary on stronger loan growth is that only the mortgage conversation or are you seeing using commercial drive the bulk of that increase going forward?

Chris Fowler

Well, as we look forward we're absolutely seeing a better outlook across the book. We're seeing it in the commercial. We are actually flat on equipment finance which is a portfolio that has declined over the last number of quarters. So we are seeing across the book opportunities, a more positive outlook particularly in Alberta which is we're obviously very happy with that. So we will continue to manage those client relationships. We again are very focused on broadening those relationships with banking. We are supporting that with our technology investment. So we're looking at every way for us to improve our client footprint and of course with the opportunities in Ontario through Maxim Financial, the Franchise Finance Group. National leasing's [ph] growth out there so that's what we're looking at across all of our lines of business to really focus on how we grow.

Sumit Malhotra

And the last one as the numbers one christened and maybe sizing your strategic you gave us and I would refer to the last question you give us a target out on where you want optimum to get to it in terms of absolute dollars but in terms of the portfolio or the reliance on it right now almost 11% of a loan book. Is there a cap in your mind as to how big optimum should be relative to the entire bank portfolio or do you not think about it that way?

Chris Fowler

Well, we do that with every portfolio we have sectorial limits that we set because we've got a risk appetite on how it is we look to grow and in every part of our book. And optimism is 11% and the Alt-A is 10% of that. So as we think about growth of Alt-A, we want that to be measured growth that is in step with the other parts of her book. We're not looking for that to immediately jump to a higher number. So we will be managing that growth and that's how we will approach that with all of our portfolios.

Sumit Malhotra

Thanks for your time.

Chris Fowler

Thank you.

Operator

Thank you and our next question comes from Robert Sedran with CIBC Capital Markets. Your line is now open.

Robert Sedran

Hello. Good afternoon. I guess I want to stay on the margin discussion if I may. And I guess I want to come at it slightly differently because ultimately we are trying to forecast net interest income not so much where the margin is going. So when I think about the added liquidity clearly carries a cost Carolyn and I'm more concerned I guess with the overall funding pressure. Is this is a net interest income headwind in addition to the margin headwind or with the - expecting would you still anticipate seeing revenue growth as well?

Carolyn Graham

We're still projecting revenue growth, absolutely.

Robert Sedran

So how significant are these margin headwinds from the net interest income perspective? The margin is going to be down somewhat but we should be focused more on the asset growth that they are funding or they're big enough that we should be worried about some of this margin pressure?

Carolyn Graham

Well we're projecting overall loan growth for the year remaining a bit below double-digit loan growth. We've talked about that from what we foresee at this point. On the margin perspective, you know loan growth will be strong margin pressure, we think will come off the 255 in the second quarter. But will still be a contributor to growth in total net interest income.

Robert Sedran

Okay. I will get back in queue. Thank you.

Operator

Thank you. And our next question comes from Doug Young with Desjardins Capital Markets. Your line is now open.

Doug Young

Good afternoon. Just sticking one question I guess with the NIM. Carolyn was there any prepayment penalty benefits that you've got in the quarter or is this just funding and liquidity?

Carolyn Graham

Nothing that would be more than a basis point or two.

Doug Young

Nothing more than, okay. And then I think also there was some you mentioned in the release some gains on securities in the quarter that you said other income was it in line with what it was last year was it higher can you quantify?

Carolyn Graham

So the gains on securities on a net basis this quarter were $0.5 million before tax and they were I believe negligible or nil in the same quarter last year. And that was primarily coming out of our debt securities portfolio as we manage the duration of that portfolio and the curve shift.

Doug Young

Okay. So not material.

Carolyn Graham

Not material nor do we think going forward material.

Doug Young

Okay. And then just like I think you may have talked a bit about this, but I think I missed it. So I apologize, but growth impaired loans from the Alberta portfolio sequentially were up about $13.3 million. I'm just wondering if you can talk about what category of loans that came through and I'm just trying to gauge that against the specific allowance declined $600,000 for gross impaired loans in Alberta. So I'm just trying to kind of look at the two moving pieces and trying to figure out what's happening.

Chris Fowler

Well, nothing in - there is nothing systemic that's happening. The increase in the gross impairments in Alberta or actually real estate and it was 1 client group essentially with no specific allowance on it. So it's just an idiosyncratic movement into an impaired loan nothing systematic there or systemic.

Doug Young

Okay. Then Chris, I guess I have the set one ratio 9.6%, I mean obviously very comfortable level. When I get asked the question how much excess capital does Canadian Western Bank have I mean what more should I use, like what's that one should I use when trying to figure that out?

Carolyn Graham

Yes, Doug we manage to a, what we consider a strong capital ratio. We view our current level as very strong so that we are holding more than our target at this point time. But we've not, we don't specifically share an exact figure.

Doug Young

So I can't corner you into a figure. Fair enough. That's all for me. Thank you very much.

Operator

Our next question comes from Lemar Persaud with TD Securities. Your line is now open.

Lemar Persaud

Tom Dick Security that's an interesting one. I'm wondering if you guys can explain the difference between the ending loan balance average loan balance. Well look at the average loan balance is down sequentially, but the ending loan balance was as a result I would have expected the pre-payments to impact NIMs by more than a basis point or 2. So maybe for Carolyn, Carolyn this question is down to your path.

Carolyn Graham

So in thinking about the average, with the average loan for the quarter down sequentially but growth it was that the growth started to come late in the quarter. So there would be less impact on net interest income in the second quarter because that growth came late in the quarter.

Lemar Persaud

But then, why wasn't the prepayment penalties an issue then? Because wouldn't that have continued that at the start at least of the second quarter and then we will see more stronger growth coming up towards the end of the quarter.

Carolyn Graham

So the prepayment penalties would only come if the reductions were because of unexpected people exiting early from their fixed term loan. So if it just a repayment of a real estate project alone on schedule at the end of the project that doesn't come with a prepayment penalty because it's expected and contractual. So it somewhat actually depends on the composition of what creating the pay down or payout.

Lemar Persaud

Okay, I understand. Then in the MD&A your bank stated that it expects to lift in mortgage applications and broker deposit price to be temporary rise in broker deposit price makes sense to me. But I am wondering why to lift in mortgage applications would be temporary if we consider that optimum would essentially be operating at a less competitive environment going forward.

So really my question is why is it only a temporary lift in mortgage application. I would expect it to be more of a permanent thing.

Carolyn Graham

I guess we really can't speak to why brokers may or may not bring in, may be bring in more or less application forward that may be a shift in housing. What's going with residential mortgages, I would say part of the issue is that as Chris mentioned we've been carefully assessing every application that comes in considering how it matches against our risk appetite. So, you know if we're receiving applications that don't fit our risk appetite and we're not moving them forward then those types may not come to us the next month or the next month.

So for us, we continue to look at the applications we triage them the ones that we think makes sense for us we do more, we do a deeper dive into and decide whether it's something that we're interested in.

Lemar Persaud

Okay. I'm going to end off by just quick numbers based questions. I'm just wondering if you could provide what was the sequential loan growth in Maxim and Franchise Finance this quarter?

Carolyn Graham

I have to come back to you on that. Maxim has had continued good growth. Franchise Finance has had good success. Their pipeline is strong, didn't get funded at the end of the second quarter, but strong looking forward.

Lemar Persaud

Okay. That's it for me. Thanks.

Chris Fowler

I think we have one more question in the queue Andrew. Andrew, are you still there? Are we offline?

Lemar Persaud

I don't know if you guys can hear this, but I can still hear you.

Chris Fowler

Okay. We seem to have lost the operator.

Operator

And our next question comes from Steven Foland [ph]. Your line is now open.

Unidentified Analyst

Thanks. Just a quick question on the broker deposits. Christine or Carolyn how much of that is cashable broker you guys see verses lifetime or basically maturity type of GIC just trying to tick a box there.

Carolyn Graham

There's about under $65 million of our total broker deposits are redeemable.

Unidentified Analyst

Okay.

Carolyn Graham

They have a term but they are redeemable.

Unidentified Analyst

Okay.

Carolyn Graham

And not a material portion of what we hold.

Unidentified Analyst

Okay, that's great. Can we just talk quickly about the acquisition related fair value changes because I guess the way we thought about it was it's a best estimate of how Maxim is doing and if it kind of does better or exceed your expectations you -- this adjustment but I guess there is some language in there suggesting that maybe that you expect that to continue for the next several years that help performance. And I guess I'm just curious about the accounting treatment for that.

Carolyn Graham

So you're absolutely right. Every quarter we estimate the expected liability related to the contingent consideration. And the contingent consideration just reminds people who might not recall is a 3 year earn-out to a maximum of $70 million. We paid out the first installment of about $10 million in the first quarter of 2017. So the amount that we've charged in the first 2 quarters is 2017 a charge similar to that for the rest of the earn-out period would take us to the maximum of $70 million. So the amount we take could shift between now and then depending on how their business success is but this would be about -- this charge would get us to the maximum earn-out.

Unidentified Analyst

Okay. So the way I read that is if it continues to outperform wouldn't you assume, like you should be taking the total $70 million into income as kind of the one-time charge or one-time adjustment or is it?

Carolyn Graham

Well you build, we build over time and in annual increments we will pay it out so the liability will shift over time and there's a probability weighted there's a probability weighted factor in that they have yet to deliver all of -- if we thought on the day that we made the acquisition that there was a 100% likelihood that we would pay out the full amount we would have recorded a $70 million liability on that date.

Unidentified Analyst

Right.

Carolyn Graham

Yes.

Unidentified Analyst

Okay. So maybe it's just the language suggest that it's almost a certainty in the MD&A when it's saying it's not. Right?

Carolyn Graham

If not yet delivered the performance, yes.

Unidentified Analyst

Okay. And just lastly Chris I will put you on the spot a little bit. With the share price decline, some are attributing it to the comments may be you made looking at the home capital portfolio if it's for sale, maybe not the optimum or a pass through deal that they have like with MCAP but certainly something in the commercial book or the consumer finance book. Can you talk that is any of that portfolio of interest if it was for sale on do you know those portfolios well?

Chris Fowler

So we definitely, what we said was we weren't as interested in all of the capital is what we exactly said and the purpose of saying that was that there was a lot of worry about that exactly that we would be up buyer of own capital. What we've subsequently said is that from all the origination we're looking to do that organically and that's how we would continue to build their book. We're interested in looking at other portfolios within home and we'll see what transpires there. We've got. We have someone asked the question early whether we're interested in portfolios, we buy portfolios and always have from across the different lines of business.

And ones that with bigger risk appetite and are in those areas that we know well and can work with we remain interested, but as we look today, we've got -- you know, we're always very careful in the areas that we land into, we wanted to be very consistent with our credit approach, our risk appetite and our culture. So we will continue to look and if something makes good sense, we would look at it if we don't find a way to get to work, we will stand aside. So we're interested to look and -- but we will make the decision when that time comes.

Unidentified Analyst

And just a follow-up, sorry. I mean, obviously if you think the portfolio is I think apples [ph], but commercial book looks good; do you think you've done your -- how do you weigh that against the risk that these association risk are contagion risk of being associated with home capital is right now? Is that -- that's obviously part of the equation, right?

Carolyn Graham

I'd say we just assess every potential acquisition or portfolio against the same lends, against our strategic objectives and against whether it makes sense with our strategic objectives moving forward.

Chris Fowler

Like whenever we buy any portfolio, anytime from anyone we do credit qualification of all the loans that are within that. So if we determine that that is acceptable, we are actually essentially re-underwriting it to our own standard and if we understand that and it makes sense, then that's what we would do. I'm not saying that we are for this particular situation but we do buy portfolios and they are credit portfolios that we have credit, analyze and determine our risk appetite.

Unidentified Analyst

Okay, thanks very much.

Operator

Thank you. And our next question comes from Dirko [ph] with RBC Capital Markets. Your line is now open.

Unidentified Analyst

Great, thank you. A couple of questions for you on the loan growth; it's good to hear that it's reaccelerating. And I guess the question that comes to mind now though is where exactly -- which pockets are you expecting the most amount of acceleration? And to what extent -- what is it that -- are there pockets where you can cast on some of the higher funding costs and pockets where you can't and maybe you can speak to the dynamics of why that we should expect margin pressure? You know, I'm hearing that in many cases in the mortgage market; you can pass on the higher costs. So I'm just curious as to where on the commercial side you're seeing very competitive behavior and where you're expecting most of your growth?

Chris Fowler

So in terms of loan growth, it is from across the book essentially. Our highest yielding portfolio historically has been equipment finance book, second highest has been our real estate project loan book and those two are certainly getting their legs under them, we've had some good growth in particularly in our commercial lending as well. So you know, it's -- our core client is that business owner, that mid-market commercial client. We haven't changed our core clientele, I mean clearly an improving economy is beneficial for those clients in terms of where they are looking to find financing opportunities and they are the ones that we look to continue to service and of course we've increased our addressable market by our expansion into Ontario, and particularly with the acquisition at year ago Maxium and Franchise Finance; so both of which are providing good yielding loans.

Carolyn can speak to the funding side but you know, we've certainly got -- the horse power we bring to the market is unchanged, we still have a very strong business client focus and as the economy improves we do see that traction coming back as demand for credit increases and then we matched that on the funding side with stronger rent based deposits which is a big focus of ours and it's a big key part of our investment in our new technology that we brought on what the core banking system, it gives us a tremendous amount of functionality that we didn't have in our prior banking systems. So we think about our overall strategy for growth, we are focused on that mid-market commercial business owners that provide that traction for us and funding that very effectively with better branch-raised deposits and through our new banking system as really a key catalyst for that assistance.

And Carolyn, do you want to mention the spreads?

Carolyn Graham

The only thing I would add to that would be -- if we think about; it's well known that mortgage rates have increased and then the Optimum space have increased. If I think about the portfolios that today don't generate their own source of funding, so the non-branch lending opportunities at this point, Optimum, Maxium, Franchise Finance; those are the higher yielding national leasing, the higher yielding portfolios where we would expect to see perhaps a correlation between higher than recent past cost in the broker market versus what the current market is. But the mortgage one is the one where we can clearly say yields have increased, the other is something you watch overtime.

Unidentified Analyst

Okay. I guess the reason for the question is I would have thought that some of your competitors would also be facing higher funding cost and then -- and therefore as an industry you would see higher loan yields and I guess time will tell.

Carolyn Graham

Yes, I would say we're four or five weeks from when the turbulence began and we're watching and observing but it's too soon to identify a trend or something that's sticky.

Unidentified Analyst

Okay. And then with respect to credit quality, you know, you mentioned that you're going to be down to lower end of the range; is that just a function of an improving economy or is it that the collective allowance increases where it won't be as necessary going forward and I'm really trying to gauge kind of where you're sitting on that with respect to -- and what I really care about is next to your frankly, in terms of the range for provision for credit losses. I'm sensing that if we're turning on the economy and from a collective allowance point of view, if you don't really have to add to it, we could be in a much lower range for next year. What would your thought process be on that?

Carolyn Graham

I think at this point you know, the 26 basis points that we are year-to-date is far better than last year, it's not yet to our most recent sort of traditional 18 to 23 basis points but it's getting certainly backed down to there. And I would say what we see today, we expect that trend could continue. Our collective allowance continues to be conservatively provided, so I wouldn't anticipate material changes but we continue to monitor that every quarter and assess what the portfolio looks like.

Chris Fowler

Yes, and we've come out with a higher range of provisions for this fiscal year because we're looking at the past and saying as you come out of a recession you often have clients that don't make it and that's where we put a higher range of 25 to 35 this year. So here we are happy to the year and we're at the lower end, so that's good and included as good but you know, I think we're still always very cautious and conservative as we look at that -- we obviously have a great track record of credit quality and we certainly look to manage our loans very, very closely and should preserve that strong credit quality.

Unidentified Analyst

And your bank is not early adopting on IFRS-9, so it will be using that sort of same methodology into 2018. Is there any thought process on proactively building the collective and reducing the possibility of a bigger reserve build when you do actually build or do actually foot over to IFRS-9?

Carolyn Graham

So you're right, we are not early adopting IFRS-9. You know, up until the day you become IFRS-9 you are existing IFRS; so we'll continue to conservatively provide under the current incurred loss model until we get there.

Unidentified Analyst

Okay. Alright, thanks very much. Thanks for your time.

Operator

Thank you. And our next question comes from Sohrab Movahedi with BMO Capital Markets. Your line is now open.

Sohrab Movahedi

Do you have the management bandwidth right now for another question?

Chris Fowler

Well, what we've -- as we think about acquisitions last year, as we -- actually we're able to bring into -- you know, we're extremely impressed with both potentially financed [indiscernible]. I think any time you make an acquisition, you definitely want to look at what the composition of the --

always take into view that any acquisition has to be strategic, creative and a cultural fit and those are always good things to think about and that management strength [ph]. You know, any access we did, we would look to typically to have management to come with that.

Sohrab Movahedi

Okay. And Carolyn, for the type of loan growth that you were expecting; I mean how are RWA [ph] intensive is to incremental loan growth being here? In other words, are we just going to see organic growth to them that high capital ratio is here?

Carolyn Graham

I think we're evaluating all options to manage the current capital strength, so we'll assess that. I think this quarter's growth came -- was more heavily weighted towards residential mortgages which comes at a lower risk weighted assets as we look forward out for the backend of the year. As Chris mentioned, we expensed in fact all portfolios to contribute, so it would be more consistent with our historic RWA and overall RWA weighted average.

Sohrab Movahedi

Okay. Thank you very much.

Operator

Thank you. That does conclude our Q&A session. I would like to turn the call back to Matt Evans for further remarks.

Matt Evans

Thanks, Andrew. Thank you very much for your continued interest in CWB Financial Group. We look forward to reporting our 2017 third quarter results on August 31. And with that, we wish you all a good afternoon.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.