Canadian Western Bank's (CBWBF) CEO Chris Fowler on Q1 2017 Results - Earnings Call Transcript

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EPS of $0.61
Revenue of $175.84M (+ 10.8% Y/Y)

Canadian Western Bank (OTCPK:CBWBF) Q1 2017 Results Conference Call March 2, 2017 2:00 PM ET

Executives

Matt Evans - AVP of IR

Chris Fowler - President and CEO

Carolyn Graham - EVP & CFO

Kelly Blackett - EVP, Human Resources and Corporate Communications

Glen Eastwood - EVP, Business Transformation

Darrell Jones - SVP, CIO

Stephen Murphy - EVP, Banking

Bogie Ozdemir - EVP, CRO

Analysts

Meny Grauman - Cormark Securities

Gabriel Dechaine - National Bank

Sumit Malhotra - Scotia Capital

Robert Sedran - CIBC

Doug Young - Desjardins Capital

Lemar Persaud - TD

Nick Stogdill - Credit Suisse

Sohrab Movahedi - BMO Capital Markets

Operator

Good afternoon, my name is Latoya and I'll be your conference operator today. At this time, I would like to welcome everyone to the CWB's Financial Group First Quarter 2017 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instruction]

I will now turn the call over to Matt Evans, Senior AVP of Investor Relations. Please begin.

Matt Evans

Thank you, Latoya. Good afternoon my name is Matt Evans, and as Latoya mentioned, AVP Investor Relations Team for CWB. Presenting to you today is Chris Fowler, CWB's 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. Our forward-looking statements advisory is found on Slide 11.

I'll now turn the call over to Chris.

Chris Fowler

Thank you, Matt. The agenda for today's call is on the second Slide, and I'll begin with our first quarter performance highlights and a brief comment on loan growth. Carolyn will follow the detail on our first question 2017 financial highlight and I will conclude with comment on our strategic direction and outlook before you move to the question and answer session.

Moving to Slide 3, I'm pleased to say we're off to a great start this year as we execute our balanced growth strategy. This morning, we reported solid core operating performance for the first quarter including 12% annual growth of pre-tax, pre-provision income and record total revenues. We also delivered positive operating leverage and strong credit quality reflected in stable loan impairments and a provision for credit losses consistent with our expectations.

I'm also pleased to report that our first quarter net interest margin was stable compared to the same quarter last year and significantly higher than last quarter. It's too early to say as we turn the corner on this key metric, but the immediate positive impact of higher margins on CWB's earnings is notable. Total loans were up 7% for the first quarter last year while average balances increase 10%.

Our businesses in Ontario continue to deliver strong loan growth while growth within the western part of our geographic footprint has been more constrained. Overall, net loan growth was flat this quarter as new originations were offset by higher than expected payouts in Alberta, British Columbia and Saskatchewan. In Alberta and Saskatchewan, payouts have increased and certain clients have chosen to prudently direct cash flows to repayment of debt in view of lagging impact of the 2015 and 2016 recession.

We fully expect that the slowdown in these provinces due to the recession and that just what has occurred. However, there is no doubt the sentiment has started to improve. Net contraction within British Columbia this quarter reflects different factors. Included here is the relatively short duration of the real estate project loan portfolio combined with the fact that we, and our experienced clients, have been cautious with new opportunities in the space.

Certain real estate clients have also chosen to realize gains through property sales and pay back mortgage loans early as demand for Greater Vancouver commercial properties has increased. This was partly the source of our elevated prepayment penalty this quarter. Both of these dynamics related to the current environment of very high prices and the uncertain impact of recent regulatory and tax changes, we expect the impact on our growth in British Columbia to be temporary as the market adjust to new regulations.

We remain committed to our objectives to deliver double digit annual loan growth whenever prudent, while we expect overall loan growth to accelerate within an improving economic backdrop in the second half of fiscal 2017, it will be likely challenging to deliver double digit loan growth this fiscal year.

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

Carolyn Graham

Thanks, Chris. CWB Financial Group delivered a strong first quarter with record total revenues and a 12% increase in pre-tax, pre-provision income compared to last year. First quarter common shareholders net income of 50 million compared to 52 million a year ago, as a positive impact of net interest income -- positive impact on net interest income of strong 10% growth in average loan balances and stable net interest margin were offset by increased noninterest expenses, higher provision for credit losses, acquisition related fair value changes and higher preferred share dividend.

Diluted earnings per common share of CAD0.56 and adjusted cash EPS of CAD0.61 were 14% and 8% lower respectively with changes reflecting the factors I just mentioned as well as the 2016 issue at the common shares. Non-interest income of 19 million was up 32%, this was primarily related to the change in the net gains and losses on security. Negligible net gains in the current period compared to loss of CAD3 million last year. Non-interest expenses were up 10% primarily due to a 9% increase in salaries and benefit as well as higher premises equipment and software expenses.

The addition of CWB Maxium accounted for almost 60% of the change in the salaries and benefits while higher equipment and software costs primarily relate to our new core banking system. Compared to the prior quarter, total revenue growth of 4% was very strong and pre-tax, pre-provision income increased 6%. Common shareholders net income growth was also very strong at 4%, while the balance of total loans at quarter end was relatively flat compared to the prior quarter.

Net interest income was 4% higher, as net interest margin increased 11 basis points and average loan balance were stable. Non-interest income was up 2%. Diluted and adjusted cash earnings per common share increased 4% and 3% respectively. Net interest margin up 2.47% was relatively consistent with the same quarter last year and 11 basis points higher than the prior quarter.

Compared to last year, favorable changes in deposit mix contributed approximately six basis points to net interest margin or elevated prepayment penalties contributed another five basis points. The contributions to CWB Maxim Financial and CWB Franchise Finance are having a positive impact on average loan yields.

The combined benefit of these positive factors was offset by continued pressure on our contractual loan yield as well as lower yield on cash and securities. Of note, while competitive factors continue to impact loan yield, the magnitude of pressure on net interest margin from loan re-pricing for the origination and renewal of loans yielding less than the portfolio average was less this year than in prior periods.

The significant increase in net interest margin from last quarter mainly reflects the combined positive impact of elevated prepayment penalties which contributed four basis points, incremental improvement in overall loan yields and favorable changes in deposit mix. CWB's deposit mix improved with less broker deposit funding and the maturity and redemption of higher cost capital funding. While average balances and the composition of our caption securities portfolio were relatively consistent with last quarter, the yield on these assets has increased from steeping of the yield curve.

The positive first quarter impact on net interest margin of elevated prepayment penalties is expected to be temporary, an incremental net interest margin pressure from low interest rate and the competitive factors is likely to reappear. On a full year basis, we expect net interest margin to be relatively consistent with the fiscal 2016 full year level of 243. Higher net interest margin supported positive operating leverage of 2% this quarter and an improvement in our efficiency ratio to 46.0% from 46.9% last year and 47.0% in the previous quarter.

This first quarter efficiency ratio is consistent with the average over the past three years. While we expect CWB's efficiency ratio to fluctuate at levels moderately higher than the first quarter did a necessary investment to facilitate future growth. We're committed to disciplined control of all the discretionary expenses, and we expect to deliver positive operating leverage over the medium term.

Turning to Slide 6, overall credit qualities remain consistent with our expectation and reflect CWB's secured lending business model, disciplined underwriting practices and proactive loan management. The first quarter provision for credit losses of 27 basis points of average loan is within our expected range of 25 to 35 basis points for the full year. This provision compares to 18 basis points in the same quarter last year, 24 basis points in the prior quarter and 38 basis points for all of last year. Of the 15 million of provisions this quarter, 6.5 million or 12 basis points related to a single full resolved exposure operating Alberta and the territory, while 4.4 million was added to the collective allowance.

Slide 7 shows the level of gross impaired this quarter. Total gross impaired loans of a 124 million represented 57 basis points of total loans outstanding, relatively stable compared to 55 basis points last year and 58 basis points in the prior quarter. While Alberta-based loans represents 36% of our overall portfolio impaired loans within Alberta of 51 million represents 41% of total impairment.

This percentage is unchanged from the first quarter last year and down from 51% in the prior quarter. The level of gross impaired loans fluctuate as new impairments are identified and existing impaired loans are resolved or written off and does not directly reflect the dollar value of expensive write-off given tangible security held at supportive lending exposures. The entire loan portfolio is reviewed regularly to provide early identification of potential adverse trends with impairment decisions undertaken on a case-by-case basis.

Realization plans for impaired loans are monitored closely by 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 14 million this quarter are specific allowances of 5 million on loans with Alberta based security, down from 13 million one year ago and 6 million last quarter.

Our business model remains focused on secured mid-market commercial lending. As such, we have no material exposure to unsecure personal borrowing including credit cards. Last year, we took a proactive one-time provision to resolve positions within our small portfolio of loan to oil and gas producers. Remaining direct exposure to borrowers in this category now represents less than 1% of the overall portfolio. We believe the worst of the oil related credit impact is behind us.

As we’ve noted before, our loans to service companies represent 2% of our overall portfolio and are primarily comprised of term reducing advances again standard industrial equipment rather than operating lines of credit, security gets receivable or inventory. The balance of loans classified as past due to but not impaired of 227 million increased 30% from last year and decreased slightly from last quarter. It’s important to note that past due loans do not all transition to impaired, and throughout our history, we've demonstrated with the level of impaired loan does not directly correlate with write-off.

Looking forward, we continue to proactively monitor all accounts with the particular focus on those located within Alberta and Saskatchewan as the lagging impact of the 2015, 2016 regional recession continue to work through all facets of the affected economy. We also continue to carefully monitor developments within the residential housing sector. We primarily participated in housing market activity through personal mortgages and residential project financing.

CWB Optimum Mortgage continues to deliver strong growth within attractive risk profile and approximately half of the total, Ontario represents the largest geographic exposure within Optimum's portfolio followed by Alberta at 22% and BC at 17%. Optimum's business model targets affordably priced home with an average loan to value at initial funding of 68% this quarter on an average origination of 328,000. The average size of each outstanding mortgage is 266,000. We assess markets by postal code and continue to actively adjust our maximum loan to value criteria based on local conditions.

In recognition of risk within the markets like Vancouver and Toronto, Optimum Mortgage 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. Taking closer look at our real estate project loan, important to note that our portfolio across all provinces is strong and well structured, our loan funding structure require strong pre-sales supported by non-refundable deposit. These factors reduce our loss potential in the event of pre-sale recession.

Ongoing monitoring of all in-progress projects confirms there has been no material evidence of account deterioration. As Chris mentioned, net growth within the segment has slowed over the past few quarters. We continue to actively support our strong client base in this strategically important segment with well structured credit facilities. However, the combined impact of historically high prices levels, recent countercyclical measure undertaken for the federal government and policy changes implemented by the BC provincial government continues to work through the economy. Along with our experienced clients, we have been cautions with new development opportunities.

Net growth has also been affected by the impact higher than expected pay out within this relatively short duration portfolio. We're comfortable with our overall exposure the housing market, the protections inherent in our secured lending business model as well as our proactive approach to loan management. We're also very close to our clients and we continue to monitor risk related to changing levels of activity very carefully.

Slide 8 shows our very strong capital ratios at January 31. Using the standardized approach for calculating risk related assets, our common equity Tier 1 ratio was 9.5%, Tier 1 ratio was 10.8 and our total ratio was 13.0, and 8.4% our Basel III leverage ratio remains very conservative. The 30 basis points increase in our set one capital ratio compared to the prior quarter mainly reflects lower risk related assets from higher than expected loan payouts start the year.

On December 31, we redeemed all 105 million outstanding CWB Capital Trust West, which did not qualify as non-viability contingent capital under Basel III. The redemption reduced both Tier 1 and total capital rations by approximately 50 basis points. We will also redeem all 75 million outstanding 5.571% subordinated debentures on March 22nd. This redemption is expected to reduce the total capital ratio by approximately 40 basis points in the second quarter. All capital levels will remain strong.

Yesterday, our Board declared a quarterly cash dividend of CAD0.23 per common share, consistent with both last year and the prior quarter. Common share dividend increases or evaluated every quarter against our dividend payout ratio target of approximately 30%. The first question dividend payout ratio was approximately 45%, primarily reflecting the impact of both elevated provisions for credit losses over the last year as well as the higher share count.

I'll now turn things back to Chris for commentary on our strategic direction and outlook.

Chris Fowler

Thank you, Carolyn. Our objectives are clear and we're executing our strategy. Our goals include strong balanced growth of both loans and funding sources, progress towards a more balanced geographic footprint and broader diversification within targeted sectors of Canada's commercial banking industry. We expect success against these objectives to deliver performances consistent with our medium term target ranges and result in strong shareholder returns.

I would like to take a moment to underline our balanced growth is the right strategy. Most importantly, this strategy is consistent with our purpose as a financial services provider. CWB Financial Group provides growth opportunities for entrepreneurs and business owners across the country. Our clients will tell you, we approach the market differently than our competitors.

We’re more nimble, less bureaucratic, more responsive and more knowledgeable above the specific markets we target. Moving faster than our competitors is the essence of our competitive advantage. Our strategy is to deliver that differentiated approach to more clients in more markets and to ensure, we can help our clients grow for many years to come.

The bar graph on Slide 9 demonstrates the progress we've made over the past year in Ontario against our geographic diversification objectives. This performance is consistent with a purposeful trend going back more than five years that accelerated last year with the strategic addition of the CWB Maxium and CWB Franchise finance.

Slide 10 demonstrates success against our business and funding diversification strategy. Our funding diversification strategy ties directly to the fact that our next level of growth will include more multiproduct client relationships. Targeted growth of our personal deposits raise to our branches is a key part of this focus. In addition to being lower cost, these products strengthen relationships by providing clients with the tools they require to manage their finances.

The diversification objectives I discussed are integral to our strategic direction. The benefits of funding diversification are obvious and more diverse, lower cost deposit base directly supports our net interest margin and through that metric our profitability and continued increases in long-term shareholder value. The benefits of geographic and business diversification are twofold.

First, performing well against these objectives means we are reaching more clients in more markets. We are strengthening our mid market commercial banking franchise by increasing the breadth and depth of our commercial relationships and growing the value of our brand by helping more entrepreneurs and businesses grow.

Second, further diversification will help us maximize the benefits of our planned transition to be advanced approach for credit risk management. Under the advanced approach, improved business and geographic diversification supports our capital management goals as we seek to level the playing field with our large bank and creditors.

The advanced approach enhances our risk management capabilities to better risk quantification, improve risk-based pricing and economic capital estimation. These improved risk management capabilities will better equip us to target business segments that generate attractive risk returns and allocate resources accordingly. The progress we're making diversify our business and geography will position us to maximize those benefits.

Turning back to loan book, it's clear we're off to a slower start this year than anticipated. Notwithstanding, the strong growth objectives and debt within our strategic direction, our strategy is not to pursue growth for growth's sake. Instead, we aim to deliver profitable growth to well priced loan within attractive risk profile. We choose our clients carefully. We have look for good companies and target our lending to specific sectors where we understand the market and the security we take to support our exposures.

Consistent with our strategy through prior cycles, we will continue to pursue opportunities to service good companies with strong management operating within the target industry segments across the country. We are fully open for business and expect loan growth to accelerate in the second half of 207, as Alberta moves out of recession, BC stabilizes and our Ontario businesses continue to grow. While it remains our objective, we expect double-digit annual loan growth within this fiscal year to be challenging.

Of note, the impact improved margin on quarterly earnings highlights the extent to which persistent margin pressure that constrained our earnings growth over the past few years. It also highlights the significant earnings power embedded within our business model. It's clear an improving trend in this key metric will translate into material growth of CWB's intrinsic value and contribute to strong long-term shareholder returns.

Today, we operate from a very strong capital position and our strategic objectives are fully aligned with our competitive and our purpose, which is to deploy our unique, nimble and responsible approach to help entrepreneurs and business owners grow. I know that our dedicated caring teams across the organization are expanded about the future and ready to deliver to our clients.

With that, I’ll turn it back over to Matt.

Matt Evans

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

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] The first question is from Meny Grauman of Cormark Securities. Your line is open.

Meny Grauman

Sounds like you are flagging a slowdown in BC, particularly in the real estate market. But you seem hopeful that activity there will pick up soon. Just wondering what gives you confidence that you will see an improvement shortly.

Chris Fowler

Thanks, Meny. We have a very strong pipeline of clients that have categories of land holds as they'd looked at the market and they’ve taken positions where they are focused on making the right development at the right time. The challenge that we’ve seen and not just in Vancouver and the Lower Mainland, is just the delays in getting zoning approvals and moving these projects forward. So, we do see a good inventory pipeline for opportunities there. I'd also say that the market is still very strong in Lower Mainland. Our existing projects that we are advanced on there all have over 100% presale coverage of the loan amount, so a good strong market and good inventory of pipeline in behind the existing exposures.

Meny Grauman

And then if I could just follow up, time to time, you give us an update on the auction market for standard industrial equipment. I'm wondering what you are seeing in that market right now?

Chris Fowler

Well, actually, this week there is a big auction at Richie where you can check that out in the newspaper towards the end of the week, but it's -- what we've seen is fairly stable results coming out of that market. So, we haven’t seen a tail off of prices. In the last, so a year ago, we did particularly in the more specialized oil field equipment. That was down 30% to 40%. Standard industrial a year ago was down 10% to 20%. So, as we look into this year, as I say the tone in Alberta is improved, the GDP projections are positive compared to the negative growth that was experienced last year. So, we are seeing a better tone. So we anticipate that the auction results should be stable. I’m not anticipating any sort of ramp up in equipment prices, but definitely we expect to see stability. But we have a task because the Richie's auction in Evanston is this week.

Operator

Thank you. And the next question is from Gabriel Dechaine of National Bank. Your line is open.

Gabriel Dechaine

Just wanted to start with the margins that were up. And you've outlined the impact of prepayment income on margins. One of the other items that struck me, though, was the deposit gathering. I guess you've gotten some cheaper deposits as opposed to relying on the broker channel. Could you delve into that a little bit?

Carolyn Graham

Thanks, Gabe. So, we had strong growth in our branch-raised deposits, which is one of our strategic priorities, so that's very positive. The last loan growth over the quarter meant that we were able to cover a larger proportion of the total loan funding through our branch-raised deposits rather than going to the broker markets.

Gabriel Dechaine

Got you.

Carolyn Graham

So, reduced reliance on the broker market, and the broker cost did tick down in the quarter as well.

Gabriel Dechaine

Okay. So, your new funding demands were not as high, so you could be a bit more choosey on how you funded it I guess is now another way of looking at?

Carolyn Graham

Yes.

Gabriel Dechaine

Then -- sorry, I missed some of the early comments. But back to this real estate project loan stuff, on the front pages, you and your clients are being cautious on many new opportunities in the space, in the real estate book, in BC. That sounds -- and you sound confident about the real estate project book picking up. But that doesn't sound like a one-quarter item. What happened during this quarter and why do you think that's getting better all of a sudden?

Chris Fowler

I would say that that adjustment started in the spring of last year. I mean this is not something that just happened this quarter. If you kind a look at the stats in Vancouver in particularly the Lower Mainland in general, they did start to slowdown in the spring of last year. So, there is not and really it had to do with the ratio of price increases, and then of course once August came in the foreign buyer tax came into place that added more caution to the market.

So, I would say that it's about a year old. The market is -- we view as a temporary adjustment based on kind of just the market conditions. We expect -- the in immigration is so strong into the Lower Mainland. Surrey is still the fasted growing municipality in Canada. There is still attributes of the market that are supportive of growth.

Gabriel Dechaine

So prices ran up the last year, then the tax came. So housing demand petered off, and then you had older loans being paid down and not being replaced by new ones, essentially.

Chris Fowler

Yes.

Gabriel Dechaine

And you are starting to see that shift back to growth?

Chris Fowler

Yes. Well, that is the, that's how we believe the market will be adjusting. And the view that there is growth coming.

Gabriel Dechaine

Okay. Then the credit -- let's actually talk about capital. So the capital build because you didn't grow the loan book as much. I'm just wondering what if loan growth doesn't come back the way you plan it or expect it to and it keeps building capital up like we saw this quarter? Theoretically, what would you do with that, just hoard it?

Carolyn Graham

Well, I think we continue to look at all the options that we have available for us with capital management. Certainly, our first and preferred option has always been to grow into our capital through both organic growth and/or acquisitions, so that's always our first choice. The growth continues to be slow. We think it will pick up again in the latter half of the fiscal year, but continuous to be slow though then we have to look at other options.

Gabriel Dechaine

Okay. And then my last one is on the credit. So relative to my expectations, it was pretty good. But still some signs that caught my attention, like the increase in general commercial impaired loan balances and 60-to-90-day past-due loans. Those were all up quite a bit. Is this the ripple effect or latent defect of the oil price decline, and are there any particular pockets of weakness that you can highlight?

Carolyn Graham

I would say that we are seeing the ripple effects through the portfolio. So, areas like equipment finance. Some of our commercial clients, we are seeing those rippled move through as we would expect at this stage of the economic cycle. And thinking about the growth impaired loans, there is an increase this quarter in commercial exposures, there is one larger loan in there that came, when compared to this quarter and it's based on Ontario.

Chris Fowler

And I would also say that the credit outcomes are fully anticipated as we looked in to this fiscal year end and we set our target 25 to 35 basis points and naturally the range we're in. We do anticipate that the challenge of our recessions in Alberta for the last two years is a tough one and clearly our clients are working a way through that, coming into this fiscal year with the expectation of positive GDP growth. We see that as an opportunity for them. But again it's the expectations on our credit quality is right where we expect it to be.

Operator

The next question is from Sumit Malhotra of Scotia Capital. Your line is open.

Sumit Malhotra

I want to start on the outlook for loan growth. I don't think it's surprising to hear that double digit is going to be a difficult endeavor for the Bank this year. But specifically thinking about Alberta and Saskatchewan maybe coming out of the recessionary environment, maybe not, when you've got Alberta down year over year and Saskatchewan basically having flat-lined, this is 40% of your book. How confident are you that there is going to be sufficient growth in these regions for you to keep loan growth on the whole portfolio even at positive levels this year? Is there enough of a spring back you are seeing economically to lead you to believe the underlying demand is there to keep these positive in 2017?

Chris Fowler

As we've talked with our regional managers and sort of going up from the branches, there is activity and clearly the positive is more positive sense than in Alberta, which is really driven by more stable oil prices will look to create some opportunities on the lending side. So, we continue to focus on what those particular opportunities are. We've got a very strong sales force through our branch network. We've had a very long history of double digit growth. We've got a very targeted approach. Our view is that where we have the opportunity to grow, we will take advantage of it and we’re getting that sort of positive feedback that the tone is better. So, I think that is where we see the optimism from.

Sumit Malhotra

And those two geographies in particular, you expect you will have growth from the portfolio on a full year basis this year?

Chris Fowler

On this last year, we were minus 6% in Alberta where a lot of the pay backs came through our equipment finance department, which really was driven by the oilfield services side and little bit pull back there. As we look into this year, we're anticipating not to be in the negative category in that it's hard to have the perfect crystal ball, but we see the GDP expectations are positive. So as we look into this year and the opportunities -- like, for instances, this year, there is double the rigs in field than the last 12 months ago. So that the positive outcome, so we do anticipate there'd be more activity and we've got more opportunities for capital expenditures and are anticipating financing pattern.

Sumit Malhotra

That's helpful. Just on the other side of the net interest income. Obviously, this is very important for you, so I want to make sure I'm thinking about it correctly. So I think you are saying half of your net interest margin increase this quarter is as a result of the prepayment fees. Even X of that, one of the reasons you were confident in your ability to keep NIM flattish this year was the fact that underlying loan yields, I think for lack of a better term, had bottomed. You were writing new business at the same levels of your existing portfolio. So X of the prepayment fees, would your yield on loans now, in your view, is that prediction playing out? That you are seeing basically no change in the underlying spreads on your loan book?

Carolyn Graham

That is what we’re seeing sort of say in our historic book. And then, we’re getting a bit support as the CWB Maxium as those loans come on our book at a higher spread.

Sumit Malhotra

All right. So, actually the prepayment fees then that’s playing out?

Carolyn Graham

Yes.

Sumit Malhotra

And last one, I want to go to Chris. And you spent a lot of time on your strategic initiatives and longer-term outlook. What I haven't heard the Bank talk about in some time is your return on equity objective. The last three quarters since you took that heavier level of provision, you have been in and around 10%. I think we can agree there has been some headwinds. Obviously, loan losses are higher than historical averages. NIM has been under pressure. But you are also carrying a lot more capital, which has brought the balance sheet leverage down. When you think about a normalized environment for CWB in the interim, where do you think that ROE, which is right now not too far from a cost-of-capital type level of 10%, can be managed to by the Bank?

Chris Fowler

Well, we've said our medium term target at 12% to 15%, and as we look at that, the key driver for us of course is net interest margin. THAT'S the biggest sort of delta impact in that in insurance equation. So, we look at our book of business and how we look to price it, we are making very distinct choices on how it is we are growing, the returns we're looking to receive from our loan portfolio, the manner under which we fund it, the lower cost deposit. We've made significant investments in our ability to gather deposits better with our new core banking systems.

So, as we think about our midterm returns at 12% to 15% range, we believe that it's achievable and is achieve by the fact that we -- our strategy to broaden our geography to find the opportunity with growth in Ontario the new businesses with strong yields with the opportunity to garter more lower cost deposits in our branches which is gaining great traction. So, all of the work we're doing came in behind on our strategy is to support that midterm

ROE level in that 12% to 15% range. So, that’s really where our focus is and that’s where actions are looking to drive.

Sumit Malhotra

Yes. To be clear, you'd have to get the PCL back into the historical range, I think, would be step one. And then it's a reflection of what you can do on the NII total, along with the loan growth?

Chris Fowler

Absolutely, on the NII.

Operator

Thank you. The next question is from Robert Sedran of CIBC. Your line is open,

Robert Sedran

Carolyn, I just wanted to come back. It seems like there are so many moving parts on that margin I just want to understand one of your answers. I believe it was to Gabe's question. It sounds like part of the reason that the margin was up is that you were able to fund more effectively because you didn't have as much long growth. So now as you think about the prospect of accelerating loan growth, I know one of the strategic initiatives is to increase the deposits. Do you think you can keep pace with that loan growth now with the new system in place, the new push to be able to support that loan growth with more CWB-originated deposits? Or you think it might bring back some of that margin pressure?

Carolyn Graham

So, we are seeing strong momentum on the branch-raised deposit growth, so we believe that will continue through -- that will continue. That is one of our strategic priorities. So, we believe that we will continue to move towards more reliance on the branch-raised. We know that we’ll always use the broker deposit market as our bill and funding. But we’ve also had, if we think about the other -- the other sources of funding or the capital market sources of funding, we have seen our credit spreads coming quite significantly. We did a successful senior deposit note issuance in January. We've redeemed the less, which were at 6.2%, the sub debt that will redeem at the end of March is at 5.6. Again, all things that when replaced with other sources of funding are positive to NIM and helps support NII, so we do see that there are sustainable support for NIM going forward on the deposit funding side as well.

Robert Sedran

But it sounded like -- and maybe I'm mischaracterizing it. It just sounded like you suggested that from here we were going to go back to some mild -- I don't even know if it's called margin pressure. It's more of a leak than margin pressure. And is it, I would assume, coming more from funding mix than coming from anything on the lending side?

Carolyn Graham

It could be either, right. I mean, on the lending side, we still have competition on pricing primarily, not on structure, but the pricing competition continues. We haven’t seen competitors exit in any of our markets as we worked our way through the last couple of years.

Operator

Thank you. The next question is from Doug Young of Desjardins Capital. Your line is now open.

Doug Young

My first question, Carolyn, just maybe some number questions. But the prepayment penalty -- have you sized that in terms of the pre- and post-tax impacts? I'm getting to about CAD0.02 to CAD0.03 per share. Is that about right?

Carolyn Graham

The differential over either quarter four or quarter one last year is about 1.6 million before tax, this is probably more like $0.01.

Doug Young

Okay, so I'm a little bit high on that. Okay. And then just your NIM outlook, you suggested NIMs for fiscal 2017 would be similar to 2016, about 2.43%. So just want to make sure that I heard that right, in that -- that essentially implies about a 2.40% NIM for the next 3 quarters. Did I hear that right?

Carolyn Graham

Yes.

Doug Young

Okay. And then, Chris, I just want to go back. I think last quarter, you seemed a little bit more optimistic on double-digit loan growth going forward. Obviously, things have changed and it looks like that's going to be a challenge for fiscal 2017. Just curious -- and you talked a little bit about different things. What was the biggest impact that caused you to change your views and change the outcome? Is there two or three different things that had a more powerful impact?

Chris Fowler

The biggest thing is just loan repayments that have come from projects coming back more quickly. We've had just more sort of lumpy loan repayments. And many of those loan repayments also come from the Vancouver commercial markets where we've certainly seen a very big uptick in commercial prices, which we've seen some financial mortgage come back to us as well where there have been opportunities for our borrowers to make some good profit. So things that we didn't have budgeted in that we look at our fundings quarter-over-quarter, they are very similar from Q4 to Q1, but we did see more repayments than we had anticipated. And that's the biggest change.

But as we look forward, our strategy is to continue to be very focused on our markets where we well capitalized, well funded. Our Ontario markets are growing very well and we anticipate with the GDP improvement in Alberta, there will be more opportunity here and have the Lower Mainland and BC adjust there is still very good opportunities for growth in BC as well.

Doug Young

And then obviously there is two big pipeline projects, potentially. Have you thought about what the potential implications of those could be on Canadian Western Bank?

Chris Fowler

We haven't based our budget on those going ahead. We're obviously very happy that there has been approval of pipelines in Canada. I think that's a key economic benefit and a key driver for many parts of our economy and we're very supportive of those approvals of pipelines. But we haven't taken that as reliance for our growth, but absolutely the companies that we involved in the construction of those pipelines are our target clients and the clients to which we land today. And that would be on the construction side. That would be on the oilfield services side. So, we would see tremendous opportunity with those pipelines going forward. But as I said, we haven't built that into our budget at this point.

Doug Young

Okay. And then just maybe lastly, obviously regulatory capital robust. The question was asked about buybacks or whatnot. And just want to see if your strategy around acquisitions has changed. I think equipment finance was one area, wealth management was another area. I would have figured there would have been something sooner than later or maybe on the wealth management side seems to be taking a little bit longer. Is that just the bid/ask spreads are too wide you're not able to find partners? Can you maybe just flesh that out?

Chris Fowler

Well, on the wealth side, we're still very interested there. We've done a big deals internally and we're just kind of at the end of the year two of that build. The first year, we're developing our strategic direction and plan for that group. Second year was getting CEO in place which is David Schaffner and he's up and running. So, what we've done this past year is created CWB Wealth Management. We worked very closely with our joint investment management and claiming partners, so that we have a much more integrated wealth management platform.

So, we have that all in place and concluded now, which is taken a lot of work. So looking forward, we're very interested in wealth management acquisitions. And again that would be mostly within our Western Canada footprint. So, it is an area, we went down the road last year looking with the couple of particular ones. We would continue to do that with the right opportunity and it absolutely on our look forward horizon.

Operator

Thank you. The next question is from Lemar Persaud of TD. Your line is open.

Lemar Persaud

Slowdown in loan growth this quarter seems to be pretty widespread across all the different portfolios. When I look at the segments that have really driven strong volumes for CWB -- personal loans and mortgages, general commercial, and real estate project loan growth -- we are continuing to see also weak equipment financing and leasing results. I'm wondering, in light of this, what really gives you the confidence to suggest that loan growth will come back in the second half of 2017? Because in guiding to an improvement in the second half, it sounds like you are still seeing some weakness in Q2, specifically.

Chris Fowler

We are -- we're still seeing, we've hinted that's really a cycle on particularly on the project loans. So, the outcome of a successful project loan is fully repayment. And so, that is a book of business it does turn. It turns over and we partner with very strong clients and again as I mentioned earlier that there has been slow down in that BC market we started spring. And we anticipate that as a temporary slowdown because the demand is so very high there. When we think about the other markets like equipment finance for sure there has been a pull back in Alberta with the lower oil prices what we've seen in the last two year.

But the increase in the price of oil, the increase in the number of rigs in the field that are under in utilization, I should say. Those are positive. So, they do create opportunities for more equipment finance. That's lending opportunities that we have seen in the last couple of years. And that is the portfolio where we very proactive actions by our borrowers to scale their fleets back to match their revenue prospects. So, we're very impressed with many of our borrowers. It means, if certainly challenged our loan growth balances, but I think it's been very proactive and managed the credit quality as well. But again as we look at it, it will come down to loan -- sorry to really that economic background. And we have -- we're seeing and improvement in that. And that’s what will drive the ability to grow in that book.

Lemar Persaud

And then moving onto the gross impaired loans, just one point of clarification. The increase this quarter in commercial impaired to CAD35 million from CAD18 million, was that all due to one account or one loan, specifically?

Carolyn Graham

Primarily.

Operator

Thank you. The next question is from Nick Stogdill of Credit Suisse. Your line is open.

Nick Stogdill

A quick numbers one from me. Just on the credit-related fee income line, I'm up 22% this year. I usually think about that line as being tied to loan growth, but it was obviously much stronger this quarter. So were some of the paydowns or benefits of the prepayments flowing through that line as well? And is that something that will drive it forward going forward?

Carolyn Graham

Prepayment shouldn’t go through that line mix. Can we come back to you on that one offline.

Nick Stogdill

Sure. Thank you.

Operator

Thank you. And the next question is from Sohrab of BMO Capital Markets. Your line is open.

Sohrab Movahedi

Just a couple of clarifications again. And I'm sorry, I had to be on and off, so you may have answered some of these, Chris and Carolyn. I apologize if you have to repeat yourself. Chris, the slower loan growth, does that have anything to do with just not good-quality loans being available?

Chris Fowler

I would say no.

Sohrab Movahedi

So it's not the risk selection?

Chris Fowler

It's more on pricing selection too. We've chosen to participate in loans that really are supportive our NII. We want to put our capital in the right yields and that’s part of it. I mean it's still very competitive market out there, so we're choosing particularly on commercial mortgages. We're being more focused on getting the right returns supporting for client relationships.

Sohrab Movahedi

Okay, so that's helpful. And I guess -- I know you have some -- in the right up here, you had that you expect PCL ratios -- you are still, I think, working with an assumption of somewhere between 25 basis points to 35 basis points. Is that impacted by this slower loan growth? Just having lower loan balances in the denominator, I suppose, is going to keep that PCL ratio higher.

Chris Fowler

Well, as we look at, I mean that's a fair comment. And if we look at this quarter, we have 27, we have 12 basis points in one loan, that was resolved and that fully taken out and written off. So, really 15 and then we had upward basis point in PCL -- sorry in selective increase.

Carolyn Graham

$4 million.

Unidentified Company Representative

$4 million, so from a credit perspective still a very strong quarter absent the one loan that we did fully resolve. So, we continue to be focused on that very strong management of credit, which has been our history.

Carolyn Graham

But I would say Sohrab that it is -- we are seeing sort of the ripple it affects of a two year recession in these provinces and it just continues to work its way through. So, the loans that would have been funded over the past several years are opposed to what we're funding right now.

Sohrab Movahedi

Okay, very helpful. And then did you comment or maybe you can comment on how are the acquisitions working out?

Carolyn Graham

So, they are working out very well, meeting our expectation and I can share that we made the first installment payment to CWB Maxium in December, pretty much at the maximum rate or the maximum that was available with the first installment. So, they are going very well, we're very pleased.

Operator

Thank you. And this time, I would like to turn the call back over to Matt Evans for closing remarks.

Matt Evans

Thank you, Latoya. Thank you very much for your continued interest in CWB Financial Group. Chris and Carolyn will speak later this afternoon during our Annual General Meeting to be held at 3 PM Mountain Time here in Edmonton. A link to the webcast can be found on our Investor Relations website at cwb.com, and we invite you to listen in.

We're also excited to announce our upcoming Investor Day to be held in the morning of March 28th at the Thompson Hotel in Toronto. Join us in person or via webcast for a focus look at our business line with the nationwide presence and to learn more about how they contribute to CWB's earnings power and the balance growth strategy.

You'll hear from our business leaders about their clients, their businesses and how their opportunities fit within the CWB Financial Group strategic direction. Please contact us by phone or email for further details. We look forward to reporting our 2017 second quarter results on June 1st.

With that, we wish you all good afternoon.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect. Good day.