



Credit Rating Announcement

GCR affirms Nova Merchant Bank Limited's National Scale Long and Short-term Issuer Ratings of BBB_(NG)/A3_(NG); Outlook Stable

Rating action

Lagos, 30 June 2022 – GCR Ratings ("GCR") has affirmed Nova Merchant Bank Limited's national scale long and short-term ratings of BBB_(NG) and A3_(NG) respectively, with a Stable Outlook.

Rated Entity	Rating class	Rating scale	Rating	Outlook
Nova Merchant Bank Limited	Long Term Issuer	National	BBB _(NG)	Stable Outlook
	Short Term Issuer	National	A3 _(NG)	

Rating rationale

The ratings of Nova Merchant Bank Limited ("Nova MB" or "the bank") reflect its sound capitalisation and good risk position, as characterised by minimal non-performing loans ("NPL") and credit losses. However, these strengths are partly offset by the loan book concentration and modest competitive position.

Nova MB operates within the Nigerian merchant banking subsector and continues to drive the evolution of its market position through the launch of bespoke customer-centric products/solutions and innovations to improve value propositions and meet the specific needs of its clients. Currently, the bank offers corporate and investment banking, money market activities and advisory services, which are further corroborated by the increasing operational scale of its wholly owned asset management and stock broking subsidiaries. However, Nova MB's competitive profile remained moderated given its modest market share, concentrated customer base, limited local geographic diversification, and relatively short track record.

Nova MB's capitalisation is considered sound, with capital adequacy ratio maintained above the regulatory threshold of 10%. However, GCR's computed core capital ratio moderated to 24.1% at FY21 from 30.9% FY20, as growth in risk-weighted assets ("RWA") outpaced internal capital generation. Pre-tax profit declined significantly by 51.2% in FY21, impacted by net interest margin compression, on the back of the elevated cost of funds during the year. While cognisance is taken of the bank's efforts at addressing the high funding cost, we expect the core capital ratio to range between 23%-24% over the next 12-18 months. In addition, GCR considered earnings quality as negatively impacting the assessment, as reflected by a material exposure to the highly volatile market sensitive income, which registered at 51.3% of total revenue in FY21 (FY20: 53.1%).

Nova MB's risk position is viewed to be well contained, underpinned by the relatively low NPL ratio of 0.4% at FY21 and moderate credit losses, which have historically remained below 0.5% over the review period. While the top twenty obligors accounted for a lower 64.9% of the loan book at FY21 (FY20: 98.8%), further diversification is anticipated as the loan portfolio expands going forward. Foreign currency ("FCY") exposure is moderate, with FCY loans constituting 25.2% at FY21 (FY20: 21.8%) relative to the estimated industry's average of 30%.

We have assessed funding and liquidity at an intermediate level. Nova MB's funding structure is predominantly made up of deposits. At FY21, total deposits accounted for 95% of the funding base (FY20: 93.1%), with customer deposits increasing by 30.4% during the year, on the back of improved deposits mobilisation capacity. However, given the elevated funding cost, the bank consciously crowded out the highly expensive wholesale funding from financial institutions, thereby resulting in 7.7% decline in customer deposits as at 31 May 2022. In this regard, the bank augmented the funding base

through the issuance of N13bn commercial paper in 1Q FY22. Concentration risk is evident, with the top twenty depositors accounting for 78.6% of the deposits book as at 31 May 2022 (FY21: 76.5%). The GCR long term funding ratio and stable funding ratio were 68.4% and 77.4% respectively at FY21. At FY21, GCR liquid asset coverage of wholesale funding and customer deposits registered at 4.7x and 25% respectively.

Outlook statement

The stable outlook reflects GCR's expectation that Nova MB's asset quality metrics will be sustained at sound levels despite the challenges in the operating environment. GCR core capital ratio is anticipated to range between 23%-24% over the next 12-18 months given the growth in risk weighted assets, which is expected to outpace internal capital generation. However, an improvement in net interest margin and a strong rebound in profitability will be favourably considered. Further diversification of the deposit book is envisaged with a better mix of non-financial institution corporate customers, in view of Nova MB's efforts at moderating the high cost of funds.

Rating triggers

The rating could be upgraded if Nova MB sustains capitalisation and asset quality metrics at sound levels, while also achieving further loan book diversification and significant improvement in competitive position. Conversely, a downward rating movement could be triggered by deterioration in asset quality metrics and moderation in the core capital ratio below the anticipated range of 23%-24%.

Analytical contacts

Primary analyst Lagos, NG	Yinka Adeoti Adeoti@GCRratings.com	Financial Institutions Analyst +2341 904 9462
Committee chair Johannesburg, ZA	Vinay Nagar Vinay@GCRratings.com	Senior Financial Institutions Analyst +27 11 784 1771

Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
 Criteria for Rating Financial Institutions, May 2019
 GCR Ratings Scales, Symbols & Definitions, May 2022
 GCR Country Risk Scores, June 2022
 GCR Financial Institutions Sector Risk Score, June 2022

Ratings history

Nova Merchant Bank Limited						
Rating class	Review	Rating scale	Rating	Outlook/Watch	Date	
Long Term issuer	Initial	National	BBB-(NG)	Stable Outlook	April 2019	
Short Term issuer	Initial	National	A3(NG)		April 2019	
Long Term issuer	Last	National	BBB(NG)	Stable Outlook	May 2021	
Short Term issuer	Last	National	A3(NG)		May 2021	

Risk score summary

Rating Components & Factors	Risk Scores
Operating environment	7.25
Country risk score	3.75
Sector risk score	3.50
Business profile	(2.50)
Competitive position	(2.50)
Management and governance	0.00
Financial profile	1.50
Capital and Leverage	1.25
Risk	0.25
Funding and Liquidity	0.00
Comparative profile	0.00
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	6.25

Glossary

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Income	Money received, especially on a regular basis, for work or through investments.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

SALIENT POINTS OF ACCORDED RATING

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to Nova Merchant Bank Limited. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Nova Merchant Bank Limited participated in the rating process via video conference management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from Nova Merchant Bank Limited and other reliable third parties to accord the credit ratings included:

- The audited draft financial results as at 31 December 2021
- Four years of comparative audited numbers
- Management account as at 31 May 2022
- Other related documents.

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