GCR RATINGS

Public credit rating report | Nigerian Financial Institution | August 2021*

Coronation Merchant Bank Limited

Rated Entity	Rating class	Rating scale	Rating	Outlook
Coronation Merchant Bank Limited	Long Term Issuer	National	A-(NG)	Stable
	Short Term Issuer	National	A2(NG)	

Strengths

- Sound risk position with nil non-performing loans ("NPL") and credit losses broadly comparable with industry average.
- Adequate funding and liquidity position.

Weaknesses

- Modest competitive position constrained by limited market share.
- Loan book concentration by obligors.
- Significant reliance on wholesale funding from financial institutions.

Rating rationale

The ratings of Coronation Merchant Bank Limited ("Coronation MB" or "the bank") reflect its adequate funding and liquidity position, and sound asset quality metrics, as evidenced by the nil NPL since inception to date. However, these strengths are partly offset by the bank's modest competitive position, significant loan book concentration and heavy reliance on wholesale funding from financial institutions.

Coronation MB is a strong player within the Nigerian merchant banking subsector based on its product/service delivery, loan portfolio and deposit mobilisation capacity relative to peers. Leveraging its long track record (having previously operated as a discount house for over two decades) and partnerships, the bank ensures consistent enhancement of its operational scale, particularly within the trade finance space. Reflective of its relatively small customer base and the trends across the merchant banking subsector, elevated concentration risk is perceived, with the twenty largest obligors and depositors constituting 85.0% and 75.4% of gross loans and customer deposits respectively at FY20. Also, the bank evidenced moderate market share within the Nigerian banking industry in terms of total assets, customer deposits, and loan portfolio, which are estimated at 0.8%, 0.7% and 0.7% respectively at FY20. Management & Governance is a neutral ratings factor.

Capitalisation is assessed at an intermediate level. The GCR computed capital ratio registered at 17.6% at FY20 (FY19: 19.8%) and expected to moderate to 16%-17% range over the next 12-18 month in view of the outpacing growth in risk weighted assets vis-à-vis internal capital generation. Earnings quality is considered ratings negative, reflected by

*The last rating announcement was on 20 July 2021. Rating reports are updated at least once a year from the date of the last announcement.

revenue stability risk characterised by high source concentration and a material exposure to market sensitive income, which constituted a sizeable 42.5% of total operating revenue in FY20 (FY19: 41.3%).

Risk position is sound and a key ratings strength, underpinned by the bank's nil NPL since inception to date and moderate credit losses of 0.2% at FY20, which broadly compared favourably with the industry average of about 3%. Initial assessments of the potential impact of the COVID-19 pandemic indicated that the bank will not be immune to the sector-wide challenges, which include asset quality concerns and slower loan repayments. However, this impact has thus far remained minimal, with the bank making no recourse to regulatory forbearance during the period. That said, we expect NPL and credit losses to remain at similar strong range over the rating horizon on the back of sustenance of stringent underwriting criteria and the macroeconomic environment recoveries. Conversely, the loan book is considered highly concentrated, with the top twenty obligors accounting for 85% of the loan book at FY20. While this is a rating constraining factor and typical of merchant banks in Nigeria, management expects this concentration to moderate somewhat over the short to medium term on account of the recent sectoral coverage expansion. GCR is also cognisant of the bank's significant exposures to market risk considering the substantial market sensitive income realised in FY20.

Coronation MB's funding base is considered adequate, predominantly bolstered by the debut N25bn subordinated unsecured bonds issued during 2020, as well as its improved deposit mobilisation capacity. As a result, the GCR long term funding ratio and stable funding ratio was robust at 80.8% and 73.1% respectively at FY20. While cognisance is taken of the sizeable (41.3%) growth in customer deposits in FY20, concentration risk is evident, with the top twenty depositors accounting for 75.4% of the deposit book, the bulk of which were from financial institutions. Positively, liquidity position is solid, with the GCR liquid asset covering wholesale funding and customer deposits by 3.9x and 53.1% respectively at FY20.

Outlook statement

The stable outlook reflects GCR's expectation that Coronation MB's asset quality metrics would remain sound despite the strains in the operating environment, albeit with the loan portfolio concentration by obligor remaining high. GCR calculated capital ratio is anticipated to moderate to 16-17% range over the next 12-18 month given our expectation that the outpacing growth in risk weighted assets vis-à-vis internal capital generation will continue to weigh down capitalisation metrics. However, GCR will positively consider a material improvement in core earnings over the rating horizon. While we anticipate liquidity to remain sound, diversification of the deposit book with a better mix of non-financial institution clients would be positively considered.

Rating triggers

The ratings could be upgraded if Coronation MB materially improves its core earnings and achieves a core capital ratio above 20% on a sustainable basis, while also maintaining sound asset quality metrics. In addition, GCR would positively consider a well-diversified loan portfolio and funding base. Conversely, a downward rating movement could be triggered by a material deterioration in GCR computed capital ratio to below 15% range, asset quality pressures and increase reliance on wholesale funding from financial institutions.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Nigeria Country Risk Scores, February 2021
GCR Financial Institutions Sector Risk Score, February 2021

Ratings history

Coronation Merchant Bank Limited					
Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term issuer	Initial	National	A-(NG)	Stable	May 2016
Short Term issuer	Initial	National	A2(NG)		May 2016
Long Term issuer	Last	National	A-(NG)	Stable	August 2020
Short Term issuer	Last	National	A2(NG)		August 2020

Analytical entity: Coronation Merchant Bank Limited

Coronation MB, formerly Associated Discount House Limited, is a wholesale financial institution, with operations covering corporate banking, investment banking, private banking and wealth management, and global markets and treasury. The bank was incorporated in 1992 and operated for over two decades as a discount house before converting to a merchant bank on 1 July 2015. Currently, Coronation MB operates from its head office in Lagos and two other branches in Abuja and Port Harcourt. As at 31 December 2020, the bank had a staff complement of 142 (FY19: 121).

Coronation MB is owned by fourteen institutional investors and the major shareholders with ownership stake above 5% as at 31 December 2020 are: Wapic Insurance Plc (22.8%), Marina Mars Proprietary Investments Limited (22.7%), Coronation Capital (Mauritius) Limited (13.3%), United Securities Limited (8.1%), Regali Estate Limited (7.5%), and Mikeade Investment Company Limited (5.6%).

Operating environment

The operating environment assessment is anchored by Coronation Merchant Bank Limited's 100% exposure to the Nigerian market.

Country risk

Nigeria's country risk score of 3.75 balances its strong economic base, supported by significant natural resources and large population, against low wealth levels, moderately weak institutional scores and currently restrained economic growth. Nigeria is one of Africa's three largest economies, with a population of approximately 190million people and contributing around 19% of continental gross domestic product ("GDP"). The size of the economy is bolstered by significant natural resources, most pertinently it is the largest oil exporter on the continent. However, like many of the continental peer group, wealth levels are low. Furthermore, commodity concentrations can cause significant economic, fiscal and currency volatility in Nigeria. This is due to both the government's dependency on oil exports for revenues and the country's high import dependency, both belying a too narrow economic base. In part due to low oil prices, but also due to restrained economic activity, GDP contracted by around 3% in 2020. We could see some rebound to growth in 2021 due to the gradual recovery from the challenges posed by the COVID-19 pandemic.

The moderately weak institutional scores are constrained by voice and accountability, rule of law, corruption and control, deterioration in security (particularly the protracted fight with the Boko Haram insurgents) and the recent surge in banditry (particularly kidnaping for ransom) across the country.

Sector risk

The Nigerian Financial Institutions Risk Score of 3.5 is supported by strong local currency liquidity within the sector and stability in the funding base (which is largely deposit based). Also, the banking sector appears well capitalized on the average. In addition, consideration was given to regulatory compliance, which is considered adequate and in line with the regional average. However, concentration of the loan book by sector (oil and gas) heightens credit risk, though with modest levels of non-performing loans. We note that the Nigerian banking sector is highly fragmented, with the top tier of the sector controlled by a few players and increasing competition amongst players within the sector. The relatively low private sector debt is expected to gradually increase going forward given the regulatory backed position of increased lending to the sector, which would enable diversification.

Business profile

Competitive position.

Modest competitive position constrained by limited market share.

Coronation MB transitioned from a discount house in July 2015 following the regulatory approval to operate as a merchant bank, having previously operated as a discount house for over two decades. The bank has since evolved to become a strong player within the Nigerian merchant banking subsector based on product/service delivery, loan portfolio and deposits mobilisation capacity relative to peers. Leveraging its long track record and partnerships, the bank ensures consistent enhancement of its operational scale, particularly within the trade finance space. Reflective of its relatively small customer base and the trends across the merchant banking subsector, elevated concentration risk is perceived, with the twenty largest obligors and depositors constituting 85.0% and 75.4% of gross loans and customer deposits respectively at FY20. Also, the bank evidenced moderate market share within the Nigerian banking industry in terms of total assets, customer deposits, and loan portfolio, which are estimated at 0.8%, 0.7% and 0.7% respectively at FY20.

Coronation MB provides end-to-end financial services to a wide range of customers to meet their specific needs via provision of bespoke products and solutions. Currently, the bank offers investment & corporate banking, private banking & wealth management, and global market & treasury services to its diverse clients. Conversely, limited geographic diversification is displayed, largely due to its operations as a merchant bank. As such, Coronation MB currently operates from its head office in Lagos, and two other branches in Abuja and Port Harcourt. While the Abuja branch provides inroad to the Northern region, the Port Harcourt office serves the South East and South South region of the country.

Management and governance

Management and governance is considered neutral to the ratings. The bank's governance structure is considered satisfactory and in line with international best practices.

Financial profile

Capital and Leverage

Capitalisation is assessed at an intermediate level. The GCR computed capital ratio registered at 17.6% at FY20 (FY19: 19.8%) and expected to moderate to 16%-17% range over the next 12-18 months in view of the outpacing growth in risk weighted assets *vis-à-vis* internal capital generation. Earnings quality is considered ratings negative, reflected by revenue stability risk characterised by high source concentration and a material exposure to market sensitive income, which constituted a sizeable 42.5% of total operating revenue in FY20 (FY19: 41.3%).

Our forecast factors over the next 12-18 months include the following:

- Internal capital generation ranging from 16%-17% in the rating horizon.
- Credit losses is expected to hover around 0.2% in 2021 and 2022.

- Core earnings to adjusted assets is expected to remain relatively stable at c.1.0% in 2021 and 2022.
- Dividend pay-out is expected to be sustained at c.33%.
- We expect the relative improvement in the macroeconomic environment to further support the bank's performance over the outlook horizon.
- Costs are expected to be controlled, with cost to income ratio of around 50%.

Table 1: Capitalisation					
	2022(f)	2021(f)	1Q 2021	2020	2019
Total Capital to RWA (%)	16.5%	17.1%	16.0%	17.6%	19.8%
Core Earnings to adjusted assets (%)	1.0%	1.1%	0.5%	1.0%	1.3%

f: Based on GCR forecasts
Source: Coronation MB financial results and GCR financial tool

Risk

Loan book concentration by obligors

Coronation MB's risk position has historically been maintained at a sound level, with NPL remaining nil since inception and credit losses registered at a moderate 0.2% at FY20, comparing favourably with industry average of about 3%. Initial assessments of the potential impact of the COVID-19 pandemic indicated that the bank will not be immune to the sector-wide challenges, which include asset quality concerns and slower loan repayments. However, this impact has thus far remained minimal, with the bank making no recourse to regulatory forbearance during the period. That said, we expect NPL and credit losses to remain at similar strong range over the rating horizon on the back of sustenance of stringent underwriting criteria and the macroeconomic environment recoveries. Conversely, the loan book is considered highly concentrated, with the top twenty obligors accounting for 85% of the loan book at FY20 (FY19: 96.2%). Similarly, sectoral distribution of the loan book remained largely skewed towards the manufacturing and agricultural sectors, which jointly constituted 81.2% of the loan portfolio at FY20. While this is a rating constraining factor and typical of merchant banks in Nigeria, management expects this concentration to moderate somewhat over the short to medium term on account of the recent sectoral coverage expansion from seven to nine sectors. While the additional sectors are oil and gas (downstream) and telecommunication sectors, other priority sectors include manufacturing, agricultural, general commerce, logistics, general, financial institution, and mining and quarrying sectors. The loan portfolio comprised mainly trade finance and overdraft facilities, which are largely short dated. Contractually, 66.8% of the exposures have maturity dates of less than three months, while 5.7% have maturity profile above one year. FCY trade loans constituted 25.4% of the loan portfolio at FY20 and considered below the estimated industry average of 35%. GCR is also cognisant of the bank's significant exposures to market risk considering the substantial market sensitive income realised in FY20.

Coronation MB's enterprise risk management framework and risk control mechanisms are considered adequate. From a risk perspective, the operational and business continuity risk on the back of COVID-19 appears to be well managed, as the deployment and continuous investment in information technology has aided business continuity amidst the challenges posed by the pandemic so far.

Table 2: Risk					
	2022(f)	2021(f)	1Q 2021	2020	2019
New loan loss provisions to average customer loans (%)	0.3%	0.2%	0.6%	0.2%	0.1%

f: Based on GCR forecasts
Source: Coronation MB financial statements and GCR financial tool

Funding and Liquidity

Coronation MB's funding structure is considered adequate, made up of customer deposits, equity, interbank funding, and borrowings, which constituted 60.7%, 12.5%, 16.3% and 10.5% of the funding base respectively at FY20. Customer deposits maintained an upward trajectory over the review period, growing rapidly by a CAGR of 36.3% in four years.

This growth was mainly attributed to the bank's improved collection on digital platforms, increased value propositions across its customer value chains and established relationships with customers to boost the relatively stable deposits. As a result, the relatively cheaper deposits improved significantly during the period, thereby leading to 600bps moderation in cost of funds to 4.8% at FY20. Analysis of the deposit book reflects concentration risk, with the twenty largest depositors constituting 75.4% of customer deposits at FY20 (FY19: 96.2%), albeit typical of merchant banks in Nigeria. In a bid to further augment its funding base, the bank during 2020 successfully issued its debut N25bn subordinated unsecured bonds, with a tenor of five years. The oversubscribed bond Issue was undertaken through a special purpose vehicle ("SPV") under an established N100bn bond issuance programme. Also, the bank issued commercial papers during the year, taking advantage of the low interest environment to augment its funding base. Overall, the GCR long term funding ratio and stable funding ratio were robust at 80.8% and 73.1% respectively at FY20.

Liquidity position is solid, with the GCR liquid asset covering wholesale funding and customer deposits by 3.9x and 53.1% respectively at FY20.

Table 3: Funding and Liquidity	2022(f)	2021(f)	1Q 2021	2020	2019
Long term funding ratio (%)	99.0%	98.3%	78.7%	80.8%	93.1%
GCR Stable funds ratio (%)	>100%	>100%	58.1%	73.1%	71.8%
GCR liquid assets/ customer deposits (%)	87.4%	87.6%	57.5%	53.1%	49.2%
GCR liquid assets/wholesale funding	7.5x	6.5x	3.9x	3.9x	6.4x

f: Based on GCR forecasts
Source: Coronation MB financial results and GCR financial tool

Comparative profile

The comparative profile is a neutral component for the ratings.

Peer analysis

The peer analysis is neutral to the ratings.

Group support

Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

No structural adjustments have been made to the Anchor Credit Evaluator in arriving at the final ratings.

Instrument ratings

No instrument rating adjustments.

Risk score summary

Rating Components & Factors	Risk Scores
Operating environment	**7.25**
Country risk score	3.75
Sector risk score	3.50
Business profile	**(1.00)**
Competitive position	(1.00)
Management and governance	0.00
Financial profile	**1.00**
Capital and Leverage	(0.50)
Risk	1.50
Funding and Liquidity	0.00
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**7.25**

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 Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Credit losses	New loan loss provisions divided by average customer loans.
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.
Internal capital generation	Profit for the year divided by prior year's equity.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
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 Ratings

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 Coronation Merchant Bank Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

Coronation 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 Coronation Merchant Bank Limited and other reliable third parties to accord the credit ratings included:

- The audited financial results to 31 December 2020
- Four years of comparative audited numbers
- Management account as at 31 March 2021
- Other related documents.