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

FBNQuest Merchant Bank Limited

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

Strengths

- Sound risk position with non-performing loans ("NPL") and credit losses broadly comparable with industry average.
- Membership of FBN Holdings Plc ("the Group").
- Adequate funding and liquidity position.

Weaknesses

- Modest competitive position constrained by limited market share.
- Loan book concentration by obligors.

Rating rationale

The ratings of FBNQuest Merchant Bank Limited ("FBNQ MB" or "the bank") balance its adequate funding and liquidity position, intermediate capitalisation, modest competitive position, and good risk profile, albeit with a significant concentration by obligors.

FBNQ MB is a wholly owned subsidiary of the Group, one of the largest financial services group in Nigeria. Leveraging its membership of the Group, and long track record (having evolved from a discount house with over two decades of operations), FBNQ MB has been able to consolidate its position within the Nigerian financial landscape. Specifically, the bank continues to harness inherent cross selling opportunities within the Group to serve a wide range of customers and ultimately enhance its financial performance and market position. Reflective of its relatively small customer base and the trends across the merchant banking subsector, elevated concentration risk is perceived, with the 20 largest obligors constituting 96% of gross loans at FY20. Furthermore, 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 0.4%, 0.3% and 0.3% respectively at FY20. Management & Governance is a neutral ratings factor, as it is in line with international best practices.

Capitalisation is a positive ratings factor, underpinned by the relatively sound GCR computed core capital ratio of 21.6% as at 31 August 2021 (FY20: 24.6%; FY19: 22.4%). Over the next 12-18 months we expect the core capital ratio to moderate to 19%-20% due to outpacing growth in risk weighted assets ("RWA") vis-à-vis internal capital generation.

*The last rating announcement was on 29 October 2021. Rating reports are updated at least once a year from the date of the last announcement.

Risk is viewed to be somewhat contained, with NPL ratio of 2.1% as at 31 August 2021(FY20: 2.6%; FY19: 3.0%) broadly comparable with the regulatory tolerable limit of 5%. Credit losses remained moderate, averaging 0.8% over the review period and stood at 0.3% as at 31 August 2021 (FY20: 0.6%). We expect the NPL ratio and credit losses to remain within a similar range over the next 12-18 months, as the gradual macroeconomic environment recovery is anticipated to forestall any significant credit migration. Positively, loan loss reserve coverage is adequate at approximately 100% over the review period. However, the loan book is considered highly concentrated, with the top 20 obligors accounting for 94.3% of the loan portfolio as at 31 August 2021 (FY20: 96%), albeit a common trend across Nigerian merchant banks. Limited foreign currency lending also benefits the bank's risk position.

FBNQ MB's funding and liquidity is assessed at an intermediate level. The bank is predominantly funded through customer deposits, which accounted for 65.9% of funding base at FY20. In line with trends across the merchant banking subsector, the bank's deposit book largely titled towards the expensive term deposits, constituting a sizeable 99.5% of the deposit book at FY20. This notwithstanding, the relatively low interest environment saw average cost of funds moderate to 2% in FY20 from 10.5% in FY19. Cognisance is also taken of the bank's propensity to mobilise deposits across the Group, thereby providing some level of funding stability. Analysis of the deposit book reflects a somewhat diversified mix, with the 20 largest depositors constituting 40.5% of customers deposits at FY20. At FY20, the GCR liquid assets covered total wholesale funding strongly 2.9x, while the ratio of GCR liquid asset to total customer deposits stood at 53.3% (FY19: 29.2%).

Outlook statement

The stable outlook reflects GCR's expectation that FBNQ MB's asset quality metrics would remain within a sound range over the rating horizon, underpinned by gradual macroeconomic environment rebound, albeit with the loan portfolio concentration by obligor. GCR calculated capital ratio is anticipated to moderate to 19%-20% over the next 12-18 months, given our expectation that growth in RWA may outpace internal capital generation and continue to taper down capitalisation. We expect the bank to continue to benefit from cross selling opportunities within the Group on a sustainable basis.

Rating triggers

The ratings could be upgraded if FBNQ MB materially improves its core earnings and achieves a core capital ratio of about 25% 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 asset quality pressures and material deterioration in core capital ratio to below our forecasted range over the next 12-18 months.

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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 Scales, Symbols & Definitions, May 2019
GCR Country Risk Scores, October 2021
GCR Financial Institutions Sector Risk Score, February 2021

Ratings history

FBNQuest Merchant Bank Limited					
Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term issuer	Initial	National	A(NG)	Stable	June 2006*
Short Term issuer	Initial	National	A1(NG)		June 2006*
Long Term issuer	Last	National	A-(NG)	Stable	September 2020
Short Term issuer	Last	National	A2(NG)		September 2020

*Refers to ratings of Kakawa Discount House Limited

Analytical entity: FBNQuest Merchant Bank Limited

FBNQ MB, formerly Kakawa Discount House Limited ("Kakawa DH"), was incorporated in 1995 and operated for about two decades as a discount house. The Group acquired 100% interest in Kakawa DH in October 2014 and subsequently secured regulatory approval to commence operations as a merchant bank in May 2015. Following the strategic decision of the Group in 2017, its investment banking division (FBNQuest Securities Limited and FBNQuest Asset Management Limited) were acquired by FBNQ MB as subsidiaries. As a result, the range of services provided by the merchant banking group ("sub-group") increased. FBNQ MB is the core entity within the sub-group, accounting for a significant 96.7% and 81.1% of assets and gross earnings respectively at FY20.

Operating environment

The operating environment assessment is anchored by FBNQuest 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 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 private sector, which would enable diversification.

Business profile

Competitive position.

Modest competitive position constrained by limited market share.

FBNQ MB is a wholly owned subsidiary of FBN Holdings Plc. Leveraging its membership of the Group, partnerships, and long track record (having evolved from a discount house with over two decades of operations), FBNQ MB has been able to consolidate its position within the Nigerian financial landscape. Specifically, the bank continues to harness inherent cross selling opportunities within the Group to serve a wide range of customers and ultimately enhance its financial performance and market position. Reflective of its relatively small customer base and the trends across the merchant banking subsector, elevated concentration risk is perceived, with the 20 largest obligors constituting 96% of gross loans at FY20. Furthermore, 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 0.4%, 0.3% and 0.3% respectively at FY20.

FBNQ 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's operations are structured along four major business divisions, namely: Corporate Banking ("CB"), Investment Banking ("IB"), Fixed Income, Currency and Treasury ("FICT"), and Sales Division. While CB oversees risk asset creation and liability generation from corporates, IB provides advisory services for mergers, acquisitions, debt and equities capital market and debt solutions. FICT is responsible for currency and fixed income trading, as well as interbank liability generation. The Sales division is responsible for liability generation and sale of the bank's products to customers. Given FBNQ MB's merchant banking operations, limited geographic diversification is evidenced, with the bank currently operating from its head office in Lagos and two other branches in Abuja and Port Harcourt. The Abuja and Port Harcourt branches provides inroad to Northern and Southern region of the country respectively, which are further supported by the highly scalable digital platforms.

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 a positive ratings factor, underpinned by the relatively sound GCR computed core capital ratio of 21.6% as at 31 August 2021 (FY20: 24.6%; FY19: 22.4%). Over the next 12-18 months we expect the core capital ratio to moderate to 19%-20% due to outpacing growth in RWA vis-à-vis internal capital generation.

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

- Internal capital generation ranging from 11%-12% in the rating horizon.
- RWA is expected to grow by about 30% on the back of the bank's improved appetite for risk asset creation.
- Credit losses is expected to hover around 0.4% in 2021 and 2022.
- Core earnings to adjusted assets is expected to remain relatively stable at c.1.3% in 2021 and 2022.
- We expect the relative improvement in the macroeconomic environment to further support the bank's performance over the outlook horizon.

Table 1: Capitalisation

	2022(f)	2021(f)	Aug. 2021	2020	2019
Total Capital to RWA (%)	19.4%	20.2%	21.6%	24.6%	22.4%
Core Earnings to adjusted assets (%)	1.3%	1.3%	0.6%	2.7%	2.3%

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

Risk

Loan book concentration by obligors

FBNQ MB's risk position is considered sound and broadly compares favourably with peers. Over the last four years, credit losses have averaged 1.0% and stood at 0.6% as at 31 December 2020 (FY19: 0.1%), against industry average of 3%. Also, NPL ratio remained within a strong range of 2.1% at August FY21 (FY20: 2.6%) relative to the regulatory tolerable limit of 5%. Given the inherent challenges posed by COVID-19 pandemic, the bank took advantage of the regulatory forbearances and restructured about 14% of its loan portfolio as at December 2020. According to management, these restructured loans are performing in line with agreed restructured terms. That said, we expect the NPL ratio and credit losses to remain within a similar range over the next 12-18 months, as the gradual macroeconomic environment recovery is anticipated to forestall any significant credit migration. Positively, loan loss reserve coverage is adequate at approximately 100% over the review period. Sectorial analysis of the book indicated a spread across key economic sectors, with significant weightings in the construction and real estate, oil and gas, and manufacturing sectors, which jointly constituted a sizeable 79.5% of the loan portfolio at FY20. Furthermore, concentration risk by obligor remained high, with the top 20 obligors accounting for 94.3% of the loan portfolio as at 31 August 2021 (FY20: 96%), albeit a common trend across Nigerian merchant banks. Going forward, management expects the recent expansion of its sectoral coverage, as well as the increased coverage from just the top corporate customers to mid corporate customers to further support loan book diversification over the short to medium term. FCY loans constituted 28.4% of the loan portfolio at FY20 and considered below the estimated industry average of 35%. According to management, FCY risk is mitigated through effective matching of assets and liabilities and hedging through non-deliverable forward contracts.

FBNQ 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)	Aug. 2021	2020	2019
New loan loss provisions to average customer loans (%)	0.4%	0.4%	0.3%	0.6%	0.1%
Loan loss reserve to non-performing loans (%)	130.2%	118.3%	97.6%	98.6%	110.6%
Gross non-performing loans to gross customer loans (%)	1.7%	2.0%	2.1%	2.6%	3.0%

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

Funding and Liquidity

FBNQ MB's funding structure is considered adequate for its current operational scale. The bank is predominantly funded through customer deposits, which accounted for 65.9% of funding base at FY20. In line with trends across the merchant banking subsector, the bank's deposit book largely titled towards the expensive term deposits, constituting a sizeable 99.5% of the deposit book at FY20. This notwithstanding, the relatively low interest environment saw average cost of funds moderate to 2% in FY20 from 10.5% in FY19. Cognisance is also taken of the bank's propensity to mobilise deposits across the Group, thereby providing some level of funding stability. Analysis of the deposit book reflects a somewhat diversified mix, with the 20 largest depositors constituting 40.5% of customers deposits at FY20. In a bid to further augment its funding base, the bank during 2020 issued N8bn senior unsecured bonds under an established N50bn bond issuance programme, with a tenor of five years. The bank has indicated plans for further issuance over the short to medium term. Overall, the GCR long term funding ratio and stable funding ratio remained strong at 82.3% and 81% respectively at FY20.

Liquidity position is solid, with the GCR liquid asset covering wholesale funding and customer deposits by 2.9x and 53.3% respectively at FY20.

Table 3: Funding and Liquidity					
	2022(f)	2021(f)	Aug. 2021	2020	2019
Long term funding ratio (%)	105.3%	106.6%	92.9%	82.3%	92.3%
GCR Stable funds ratio (%)	190.2%	194.0%	101.6%	81.0%	99.1%
GCR liquid assets/ customer deposits (%)	84.7%	85.7%	55.5%	53.3%	29.2%
GCR liquid assets/wholesale funding	7.1x	8.0x	5.7x	2.9x	77.9x

f: Based on GCR forecasts
Source: FBNQ 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

Although FBNQ MB is a wholly owned subsidiary of FBN Holdings Plc, considerations for Group support was not factored into the bank's final risk score, as the Group's total risk score of '7.75' provided limited headroom for any rating uplift.

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	**(1.50)**
Competitive position	(1.50)
Management and governance	0.00
Financial profile	**1.50**
Capital and Leverage	0.75
Risk	0.50
Funding and Liquidity	0.25
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 FBNQuest 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.

FBNQuest 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 FBNQuest 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 August 2021
- Other related documents.