



Credit Rating Announcement

GCR upgrades Nova Merchant Bank Limited's National Scale Long-term Issuer Rating to BBB_(NG); Outlook Stable

Rating action

Lagos, 10 May 2021 – GCR Ratings (“GCR”) has upgraded the national scale long term rating assigned to Nova Merchant Bank Limited to BBB_(NG) from BBB_(NG) and affirmed the national scale short term rating at A3_(NG), with a Stable Outlook.

| Rated Entity | Rating class | Rating scale | Rating | Outlook/Watch |
|----------------------------|-------------------|--------------|---------------------|----------------|
| Nova Merchant Bank Limited | Long Term issuer | National | BBB _(NG) | Stable Outlook |
| | Short Term issuer | National | A3 _(NG) | |

Rating rationale

The rating upgrade is underpinned by Nova Merchant Bank Limited's (“Nova MB” or “the bank”) evolving brand, strong capitalisation and risk position, and adequate liquidity. However, these rating strengths are partly offset by the loan book concentration and modest competitive position, given its limited scale and track record.

Nova MB, which operates predominantly within the Nigerian merchant banking subsector, continues to drive evolution of its market position through the launch of bespoke customer-centric products/solutions and innovations to improve value propositions and meet specific needs of its clients. Currently, the bank offers corporate banking, money market activities and advisory services to its customers. Furthermore, the launch of four new mutual funds by its asset management subsidiary in FY20 provided additional impetus for diverse product offerings. However, Nova MB's competitive position is constrained by its moderate market share, concentrated customer base, limited local geographic diversification and short track record of about four years. Management & Governance is a neutral ratings factor.

Nova MB's strong capitalisation is a key rating strength, with capital adequacy ratio (“CAR”) maintained well above the regulatory threshold. As at FY20, CAR stood at a satisfactory level of 39.7% (FY19: 54.2%), comfortably exceeding the minimum requirement of 10%, thus providing adequate headroom for risk asset growth. Similarly, GCR's computed core capital ratio stood at 31% at FY20 (FY19: 55.6%) and considered robust. Over the next 12-18 months, we expect Nova MB's capitalisation metrics to be weighed down (albeit remaining at a sound level) by its operational expansion drive and accelerated loan book growth, as well as the consequential increase in risk weighted assets. That said, we expect GCR core capital ratio to remain at c.25% over the rating horizon. Earnings quality is a moderate ratings negative, reflected by revenue stability risk characterised by high source concentration and a material exposure to market sensitive income (47.3%). Yields from government foreign currency bonds/ securities account for the bulk of market sensitive income. However, the bank's increased value proportion, and lending activities could further support earnings diversification and accretion going forward.

Risk is viewed to be somewhat contained and neutral to the ratings. Nova MB's non-performing loans has remained nil since inception and credit losses of 0.2% broadly compares favourably with industry's average at c.2%. Initial assessments of the potential impact of the COVID-19 pandemic indicate that the bank will not be immune to the sector-wide challenges which include credit extension and slower loan repayments. However, this impact has thus far remained minimal with the bank making no recourse to regulatory forbearance during the period. Limited foreign currency lending also benefits the bank's risk position. Conversely, the loan book is considered highly concentrated, with the top twenty obligors accounting for 98.8% of the loan book at FY20. While this is a rating constraining factor, management expects

this concentration to moderate somewhat as the loan book expand over the short to medium term. GCR is also cognisant of the bank's significant exposures to market risk in view of the substantial market sensitive income realised in FY20. Further heightening the risk profile is the related party exposures which constituted 16.2% of the loan portfolio at FY20.

Funding and liquidity is assessed at an intermediate level. Nova MB's funding structure is considered robust for its current operational scale and was largely augmented by the issuance of N10bn subordinated unsecured bonds in FY20, with a subscription level of over 300%. Analysis of the funding structure reflected that customer deposits, equity, interbank funding and borrowings constituted 62%, 15.9%, 15% and 7.1% of the funding base respectively at FY20. While cognisance is taken of the significant (121.2%) growth in customer deposits in FY20, concentration risk is evident, with the top twenty depositors accounting for 81.4% of the deposits book, the bulk of which were from financial institutions. The GCR long term funding ratio and stable funding ratios were 74.6% and 69.6% respectively at FY20. Overall, liquidity is considered strong, with the regulatory liquidity ratio consistently maintained well above the regulatory threshold of 20%. At FY20, GCR liquid asset coverage of wholesale funding and customer deposits was strong at 6.4x and 46.9% respectively.

Outlook statement

The stable outlook reflects GCR's expectation that Nova MB's financial profile would remain resilient despite the strains in the operating environment. The outpacing growth in risk weighted asset *vis-a-vis* internal capital generation could see GCR core capital moderate to c.25%. That said, we could make a negative adjustment to the risk scores if GCR core capital ratio declines materially below 25% without commensurable improvement in loan book concentration and related party exposures. Credit losses is also expected to increase moderately but without a material adverse impact on loan exposures. While we anticipate liquidity to remain sound, diversification of the deposit book with a better mix of non-financial institution corporate clients would be positively considered.

Rating triggers

The rating could be upgraded if Nova MB sustain its strong capitalisation, contains NPL and credit losses below industry's average, achieve loan book diversification as well as achieve significant improvement in competitive position. Conversely, a downward rating movement could be triggered by material deterioration in capitalisation and asset quality, and increased 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 Scales, Symbols & Definitions, May 2019
- GCR Country Risk Scores, February 2021
- GCR Financial Institutions Sector Risk Score, February 2021

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 | April 2020 |
| Short Term issuer | Last | National | A3(NG) | | April 2020 |

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 | 1.75 |
| Capital and Leverage | 2.25 |
| Risk | 0.00 |
| Funding and Liquidity | (0.50) |
| Comparative profile | 0.00 |
| Group support | 0.00 |
| Government support | 0.00 |
| Peer analysis | 0.00 |
| Total Score | 6.50 |

Glossary

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|-------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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 financial results to 31 December 2020
- Two years of comparative audited numbers
- Other related documents.

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