CardinalStone Partners Limited

Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

CardinalStone Partners Limited

Rating:

Bbb-

Outlook: Stable
Issue Date: 19 June 2020
Expiry Date: 30 June 2021
Previous Rating: NA

Industry:
Financial Services

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Rating Rationale

CardinalStone Partners Group's ("CSPG", "the Group") rating is supported by good profitability, adequate capital, a good liquidity and funding profile and a stable management team. The rating is, however, constrained by high non-performing loan (NPL) ratios in the consumer and structured finance loan books, substantial exposure to unrated related parties and concentration in various portfolios. CSPG's asset quality weaknesses further point to limitations in the Group's risk management processes. The impact of the weak global and domestic economic environments has also been taken into cognisance.

CSPG began operations in 2008 providing asset management, financial advisory and investment banking services. The Group's business has since expanded to include securities brokerage, registrars and consumer lending services. CSPG through various member entities is registered with the Securities and Exchange Commission as an issuing house, fund manager, broker/dealer and registrar and has a finance house licence from the Central Bank of Nigeria. The Group also makes proprietary investments in listed equity, fixed income and private equity.

As at 31 December 2019, CSPG's assets were 26.3% invested in low risk FGN T-bills and 24% held in bank balances and placements with financial institutions of largely investment grade credit quality. Loans to individuals and companies accounted for 13.4% of the Group's total assets while investments in listed equities, bonds and Eurobonds accounted for 9.3%, 7.2% and 5.8% respectively. However, the consumer and structured finance loan books recorded NPL ratios of 22.6% and 7% respectively, both above our benchmark of 5%. There was also substantial exposure to related parties at an equivalent of 49% of shareholders' funds and significant concentration in the Group's bank balances, placements, structured finance loans, equities and Eurobonds portfolios.

CSPG's asset creating business units act as the first line of defence in the risk management structure by following established and documented policies to stay within acceptable risk limits. The structured finance loans and margin loans are also collateralised to reduce the expected losses given default. The Group's risk management and internal control teams conduct daily checks to verify compliance with policies. However, we noted that constraints set by some manuals were regularly bypassed with the use of exceptional approvals. The Finance, Credit & Risk Committee, which is chaired by an independent director, consists of one executive and three non-executive board members. In our opinion, risk management can be improved with more dedicated capacity and robust front office integration.

During the 2019 financial year, CSPG generated net earnings of ₦2.9 billion and recorded a profit before tax of ₦1.3 billion. The Group's 2019 pre-tax return on average equity (ROE) of 43.2% and pre-tax return on average assets (ROA) of 5.4% out-performed peer United Capital Group's ("UCG") figures of 27.9% and 3.3% respectively in the same period. In our opinion, CSPG's profitability is good. The Group's annualised pre-tax ROE and pre-tax ROA for 2020 are lower at 18% and 3% respectively based on the unaudited figures for the first five months. We believe that with the exception of consumer lending, CSPG's businesses have the client base and experience to weather the COVID-19 storm in 2020.

As at 31 December 2019, CSPG had shareholders' funds of ₦4.3 billion following an equity issuance in the review period and capital to risk weighted assets ratio stood at 28%, which was better than our benchmark. The Group's debt to equity ratio was low at 1.45 times, better than peer UCG's ratio of 3x. Total assets were funded 60% by clients' funds under management, 23% by liabilities and 16% by shareholders' funds. Although there was some concentration in funding as the top 20 clients accounted for more than 50% of clients' funds management, CSPG recorded a liquid assets to total assets ratio of 73%, better than the regulatory benchmark of 60%. In our view, the Group is well capitalised and has a good liquidity and funding profile.

Based on the aforementioned, Agusto & Co. assigns a "**Bbb-**" rating to CSPG.

Table 1: Financial Data for CardinalStone Partners Group

	31 December 2019	31 December 2018
Total Assets	₦26.7 billion	₦21.2 billion
Gross Earnings	₦4.3 billion	₦3.1 billion
Pre-tax return on average assets	5.4%	3.2%
Pre-tax return on average equity	43.2%	33.1%

Source: CardinalStone Partners Limited

Strengths

- Good profitability
- Adequate capital
- Good liquidity and fundng profile
- Stable management

Weaknesses

- High NPLs in consumer and structured finance portfolios
- Concentration to individual entities in various asset classes
- Significant exposure to related parties in assets
- Sub-par risk management structure and oversight

Challenges

- Ability to sustain asset quality in the face of weak macroeconomic climate.
- Sustaining performance in the adverse business climate.

GROUP PROFILE

CardinalStone Partners was incorporated as a private limited liability company and began operations in 2008, providing investment banking, financial advisory and asset management services. The Group's business has since expanded organically and through acquisitions to include securities brokerage, registrars and consumer lending services through investment in subsidiaries: CardinalStone Securities, CardinalStone Registrars and CS Advance Finance Company. CSPG's asset management business has also been carved out of the parent entity and transferred to a standalone subsidiary CardinalStone Asset Management.

CardinalStone Partners and subsidiaries: CardinalStone Registrars, CardinalStone Securities and CardinalStone Asset Management are registered with the Securities and Exchange Commission as an issuing house, registrar, broker/dealer and fund manager respectively. CS Advance Finance Company has a finance house licence from the Central Bank of Nigeria. The Group holds a 20% equity stake in private equity firm, CardinalStone Capital Advisers, which was established in 2016 to promote and manage private equity funds.

Table 2: Group Subsidiaries

Entity	Shareholding	Year of Incorporation
CardinalStone Securities Limited	99.99%	2008
CardinalStone Registrars Limited	77.7%	2002
CS Advance Finance Company Limited	95.0%	2016
CardinalStone Asset Management Limited	99.99%	2016

Source: CardinalStone Partners Limited

CSPG provides investment banking and financial advisory services including structured lending to midcap companies; asset management, securities trading and margin lending services to high net-worth individuals and institutional clients; registrar services to public organisations and consumer loans to middle to low income individuals in full-time employment. The Group also makes investments in fixed income and equity securities via a proprietary trading desk and has private equity investments in unlisted companies.

CSPG's controlling interest is owned 40.7% by CardinalStone Limited, 16.8% by Bridgehampton Integrated Service Limited, 8.3% by Ifenwona Investments Limited, 8.2% by Mr Fola Adeola and 5.2% by Chizzy Nigeria Limited. The remainder 20.8% of the Group is held by 10 other individuals and organisations. CSPG was co-founded by Messrs Femi Ogunjimi, Michael Nzewi, Mohammed Garuba and Yomi Jemibewon, who sit on the Board of Directors. The Group's Board is chaired by Mr Fola Adeola and comprises seven members, who jointly own (directly and indirectly) 48.9% of CSPG.

The Group's head office is located at 5 Okotie Eboh Street, Ikoyi, Lagos. CSPG had a staff strength of 145 persons as at 31 December 2019.

Business Strategy

CSPG's strategy is to focus on core competencies of offering asset management services to high net-worth and institutional clients and investment banking and financial advisory services to blue-chip and midcap companies operating in Nigeria. The Group plans to grow assets under management (AuM) by entering the retail space with the launch of collective investment schemes as well as deepening in the high net-worth individuals and institutional client markets. CSPG plans to grow the investment banking business by expanding structured lending to clients and providing services to private equity and fintech operators as well as other businesses.

The Group also plans to grow the securities trading, margin lending, registrar and consumer lending businesses either through investment in organic expansions or acquisitions. CSPG aims to further expand its service offering by establishing or acquiring complementary businesses that offer group-wide economies of scope or opportunities to cross-sell such as pension fund administration and trustees businesses. The addition of these services to the Group's portfolio is expected to aid the retention of existing customers as well as the expansion of the customer base.

Business Structure

CSPG operates a mixed group structure with some businesses supported by centralised shared services while support services are partially centralised for other businesses. Subsidiaries CardinalStone Asset Management and CardinalStone Securities are serviced by centralised support functions legal/company secretary, financial control, risk management, internal control, compliance, internal audit, information technology and human resources. Other subsidiaries CardinalStone Registrars and CS Advance Finance Company have dedicated legal/company secretary, financial control, risk management, internal control, compliance, internal audit, information technology and human resources functions that are overseen by the respective central support departments.

The heads of the Group's proprietary business and investment banking business report to the Managing Director/CEO. The asset management business is led by a Managing Director, who is a CSPG Executive Director. The securities business is led by a Managing Director, the registrar business is led by a Chief Business Strategist and the consumer lending business is led by an Acting Managing Director. The heads of the Group human resources, legal/company secretary and financial control units report to the Managing Director/CEO while the heads of the risk management, internal control, compliance and internal audit, information technology and brand units report to the Executive Director. All the businesses have separate boards of directors.

Information Technology

Under CSPG's partially centralised information technology structure, subsidiaries CardinalStone Registrars and CS Advance Finance Company have dedicated infrastructure and developers that work with the infrastructure and developers that support the businesses at the centre. The Group uses services provided by Microsoft's Office 365 with client files stored on the cloud drive while other files are stored locally on a server. The core business applications of the Group's businesses are hosted on high-availability infrastructure with business continuity and disaster recovery services either provided by vendors or using in-house capacity. CSPG has also developed a number of proprietary software to improve the efficiency of business processes.

Track Record of Financial Performance

As at 31 December 2019, CSPG's total asset base stood at ₦26.7 billion, a 26.3% growth from ₦21.2 billion at the end of prior year. The Group's pre-tax profits increased considerably during the financial year ended 31 December 2019 by 111% to ₦1.3 billion from ₦0.6 billion in the previous year largely due to improved trading and investment income. CSPG thus reported improved profitability ratios with pre-tax return on average equity (ROE) of 43.2% (2018: 33.15) and pre-tax return on average assets (ROA) of 5.4% (2018: 3.2%).

Table 3: Board of Directors

Current Directors		Shareholding (* indirect)
Mr Fola Adeola	Chairman	8.2%
Mr Michael Nzewi	Managing Director	10.2%*
Mr Mohammed Garuba	Executive Director	10.2%*
Mr Asue Ighodalo	Non-Executive Director	Nil
Mr Femi Ogunjimi	Non-Executive Director	10.2%*
Ms Mairo Bashir	Non-Executive Director	Nil
Mr Yomi Jemibewon	Non-Executive Director	10.2%*

Source: CardinalStone Partners Limited

Table 4: Other Significant Shareholders

Significant Shareholders	Shareholding
CardinalStone Limited	40.7%
Bridgehampton Integrated Service Limited	16.8%
Ifenwona Investments Limited	8.3%
Chizzy Nigeria Limited	5.2%

Source: CardinalStone Partners Limited

Management Team

Mr Michael Nzewi is one of the founders of CardinalStone Partners and the Managing Director/CEO. He was appointed to this role in January 2017. Prior to co-founding the Group in 2008, Mr Nzewi served as a director in the Capital Markets division of Standard Chartered Bank, London from 2007 to 2008. Prior to this, he headed Corporate Finance at Vetiva Capital Management between 2004 and 2007.

Mr Nzewi obtained a BSc in Accounting from the University of Benin, Nigeria in 1997 and an MBA from Said Business School, Oxford University, United Kingdom in 2006. He is an associate member of the Institute of Chartered Accountants of Nigeria.

Mr Mohammed Garuba is one of the founders of CardinalStone Partners and an Executive Director. He is also the Managing Director of CardinalStone Asset Management. Prior to co-founding the Group in 2008, Mr Garuba served as Director of Equity Securities at Renaissance Capital, Lagos from 2007 to 2008 and before then the Managing Director/COO of Zenith Securities from 2005 to 2007.

Mr Garuba obtained a BSc in Insurance from the University of Lagos in 1998. He is a fellow of the Institute of Chartered Accountants of Nigeria. He is also a fellow of the Chartered Institute of Stockbrokers.

The Group's senior management team includes:

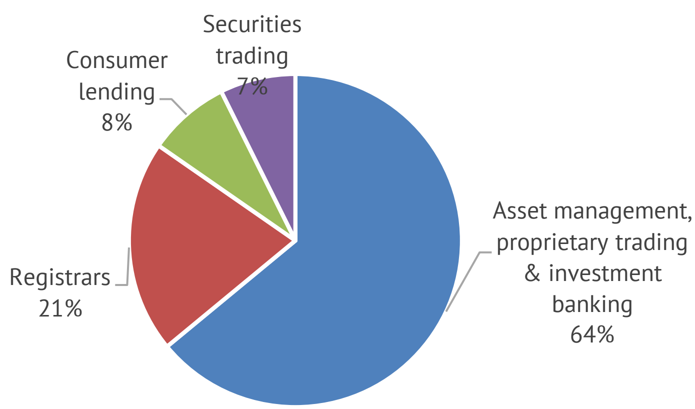
▪ Mrs Elile Olutimayin	Managing Director, CardinalStone Securities
▪ Mr Ayoola Adeola	Chief Business Strategist, CardinalStone Registrars
▪ Mr Babatunde Obadero	Acting Managing Director, CS Advance Finance Company
▪ Mrs Onyebuchim Obiyemi	Head, Investment Banking
▪ Mr Peter Omoregie	Head, Proprietary Trading
▪ Mr Oloruntoba Ayodele	Head, Financial Control
▪ Mr Olushola Ojo	Head, Risk and Internal Control
▪ Ms Azizah Abiola	Head, Legal/Group Company Secretary
▪ Mrs Oredolapo Adedayo	Head, Human Resources
▪ Mr Olutayo Oyawale	Head, Information Technology
▪ Mr Philip Anegbe	Head, Research

ANALYSTS' COMMENTS

ASSET QUALITY

As at 31 December 2019, CSPG had total assets of ₦26.7 billion, which represented a 26.3% increase from ₦21.2 billion recorded at the end of 2018. The asset management, proprietary trading and investment banking businesses jointly accounted for the largest fraction of the Group's assets with 64%, while the registrar business was the second largest contributor with 21%. Consumer lending and securities trading were CSPG's third and fourth largest businesses, accounting for 8% and 7% of total assets respectively. The increase in the Group's total assets was largely driven by growth in the asset management, proprietary trading and consumer lending businesses, following investment in planned expansions. We expect the asset management business to drive CSPG's asset growth in 2020 with increased penetration and the new CardinalStone Asset Management entity to account for the largest share of the Group's assets.

Figure 1: Breakdown of assets by business



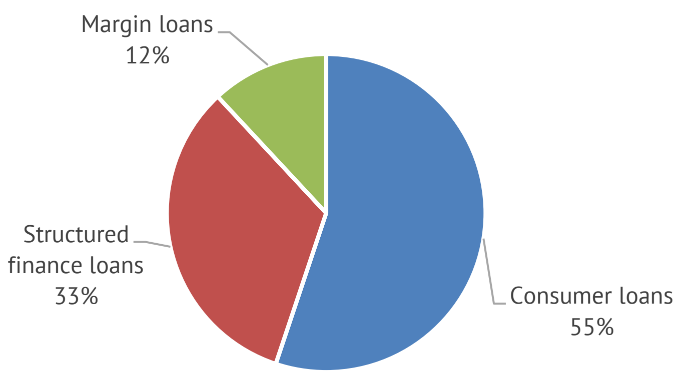
Source: CardinalStone Partners Limited

Bank balances and short-term investments comprising holdings of FGN treasury bills and placements with other financial institutions constituted the largest fraction of CSPG's assets at 50.3% as at 31 December 2019. Long-term investments consisting of listed equities, bonds, Eurobonds and other unlisted investments were the second largest class of assets with 22.6% as at the same date. Loans accounted for the third largest share with 13.4% while other assets, largely comprising trade receivables and due from related parties, were fourth largest at 9.6% of total assets. Total other long-term investments and total fixed assets & intangibles each accounted for 2.1% of total assets, making the smallest contributions to the Group's total assets as at 31 December 2019. We do not expect to see significant changes to asset allocation structure in the near term as CSPG has an established strategy for each of the businesses. However, we expect to see changes in the medium term as the asset management and consumer lending businesses have the capacity to grow fastest.

FGN treasury bills, which we consider to be of "Aaa" credit quality on a national rating scale, accounted for over a quarter of the Group's total assets at 26.3% as at 31 December 2019. CSPG's placements with other financial institutions, which accounted for 16.8% of the Group's total assets, were largely with investment grade commercial banks. However, there was some concentration with one tier II bank accounting for over 32.4% of CSPG's placements as at 31 December 2019 while there were also higher-risk placements in unrated banks that accounted for 13.8% of the portfolio. The Group's bank balances, which accounted for 7.2% of total assets and primarily comprised the registrar business' clients' dividend accounts, were also held with investment grade commercial banks. However, there was also considerable concentration in the bank balances with one tier II bank accounting for over 74% CSPG's deposits as at 31 December 2019. In our view, the Group's exposure to concentration risk in bank balances and placements is severe.

Direct loans and advances accounted for 13.4% of CSPG's total assets as at 31 December 2019. The Group's loan book consisted of assets which were created across three business lines: consumer lending, investment banking (structured finance) and securities trading (margin lending). Consumer loans, which are unsecured, short-term advances to individuals in the Lagos State environs, accounted for the largest share of CSPG's gross loans and advances at 55%. The consumer loan book was diversified, comprising more than 2,000 obligors with the top 20 obligors accounting for only 6% of the portfolio as at the end of the review period. However, we consider the consumer lending business' loan book growth of 1433% in 2019 to ₦1.9 billion (2018: ₦124 million) to be overly aggressive in a high-risk environment such as Nigeria and for a relatively new business that began lending in 2017. The repayment behaviour of the bulk of the obligors is thus yet to be observed while the efficacy of the risk management framework for consumer loans remains untested. The non-performing loan ratio of the consumer loan book in 2019 was high at 22.6%, well above the Agusto & Co. and regulatory benchmarks of 5% and 10% respectively. In our view, the impairment charge was insufficient at 42% of non-performing consumer loans with the uncovered balance equating to 4.6% of the Group's equity or 2.7 times the equity of the consumer lending business.

Figure 2: Direct loans and advances



Source: CardinalStone Partners Limited

Structured finance loans, which are short-term loans to companies and high net-worth individuals, accounted for the second largest share of the Group's loan book with 33%. The structured finance loan book comprised 13 obligors with mid-sized companies accounting for 77% of the value of outstanding loans while individuals accounted for the balance of 23%. The structured finance book had concentration with four obligors accounting for 70% of the value while seven of the total were related parties, who together accounted 53% of the book's value. The non-related party structured finance loans were collateralised by cash or marketable securities. The non-performing loans in the structured finance loans portfolio were, however, accounted for by related parties with an NPL ratio of 7% in 2019, which was worse than our benchmark. In our opinion, the impairment charge on the structured finance loan book of 50% of NPLs was too low given the exposure to unrated related parties and the historical performance. Margin loans, which are collateralised by marketable securities, accounted for the balance of 12% of CSPG's loans. The margin loans were largely granted to individuals, however, there was concentration with four of the Group's related parties accounting for 73% of the portfolio. The margin loan book did not record any NPLs during the financial year under review.

Investments in asset classes such as listed equities, bonds and Eurobonds accounted for 9.3%, 7.2% and 5.8% of the Group's total assets respectively as at 31 December 2019. CSPG's equity portfolio comprised 25 stocks which were largely big-cap from eight different industries. However, there was significant concentration with two of the stocks accounting for more than 57% of the portfolio. This led to concentration in two industries which accounted for more than 79% of the portfolio. The Group's bond investments, which consisted of FGN bonds (49%), state government bonds (28%) and corporate bonds (23%), were relatively well diversified with no issuer other than the FGN accounting for more than 20% of the portfolio. CSPG's Eurobond investments, which comprised issuances by commercial banks; however, showed concentration with one issuer accounting for 80% of the portfolio.

Amount due from related parties, which largely consisted of financing provided to fund the Group's investments in private equity, accounted for 4.8% of total assets. Overall exposure to related parties accounted for around 8% of CSPG's total assets, which was relatively high at an equivalent of 49% of shareholders' funds. Interest and other trade receivables, which largely comprised receivables from a real estate project situated in Ikoyi, Lagos, accounted for 3.9% of total assets. CSPG plans to grow the asset management, consumer lending and structured lending businesses in the near term. Therefore, we expect sizeable increases in short and long-term investments and direct loans and advances but without significant changes in the asset allocation structure. According to the Group's unaudited figures as at 31 March 2020, CSPG has not witnessed significant increases in these asset classes with the recorded figures remaining largely flat due to the challenging domestic and global environment.

In our opinion, the Group's asset quality is satisfactory with 26.3% invested in very low risk FGN treasury bills and 24% held in bank balances and placements with financial institutions of investment grade credit quality. CSPG recorded high NPL ratios in the consumer and structured finance loan books while the Group had substantial exposure to unrated related party financial assets. There was also significant concentration in the Group's bank balances, placements, structured finance loans, equities and Eurobonds portfolios which could result in sizeable impairment should one or two issuers face crises. We expect to see the NPL ratios of the consumer and structured finance loan books rise further in 2020 due to the negative impact of the COVID-19 pandemic on global and domestic economic activities.

RISK MANAGEMENT

CSPG's Board of Directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board undertakes this responsibility via the Finance, Credit & Risk Committee, which consists of one executive and three non-executive board members and is chaired by Ms. Mairo Bashir, who is an independent director. The Board Finance, Credit & Risk Committee is supported in the oversight of daily business activities by CSPG's risk management, internal control, compliance and audit functions. The Group operates a partially centralised risk management system with subsidiaries CardinalStone Registrars and CS Advance Finance Company having dedicated middle and back office personnel, who are overseen by the heads at the group level.

The Group's asset creating business divisions: proprietary trading, asset management, investment banking for structured finance loans and securities trading for margin loans, act as the first line of defence in CSPG's risk management structure. In making investment or lending decisions, the members of each of these teams follow established and documented policies that promote the Group's strategy of preserving capital and maintaining a sustainable return on investments by seeking opportunities with acceptable risk limits. Each team assesses the investment or lending opportunity using proprietary models and leverages the output and knowledge of the CSPG research team ahead of making a decision. The structured finance loans and margin loans are also collateralised to reduce the expected loss given default.

The Group's risk management and internal control team conducts daily post trade checks to verify compliance with the relevant policies with exceptions escalated to the respective reporting director. The post-trade checks are conducted on the Infoware software, which is capable of generating customised exception reports. The software, however, has not been implemented with the capability to conduct system-based pre-trade checks on the portfolio activities of the business teams. The risk management and internal control team reviews client portfolios to ensure the holdings are in line with the investment policy statements agreed with the investment advisory team or non-discretionary mandates. The risk management and internal control team produces weekly and monthly risk reports for the management team.

The consumer lending business' underwriting & risk management team is responsible for reviewing customers' loan applications and verifying documentation provided such as IDs and bank statements. The underwriting & risk management team assigns a low, medium or high risk rating to applicants by considering factors such as debt to income ratio, employment status, number of dependents and the findings of checks with credit bureaus. The results of the loan application review and obligor risk ratings are used to decide whether to lend to an applicant. Successful applicants may fall into any one of the risk buckets, with each obligor's risk profile used to determine pricing and the intensity of the collection strategy implemented for the loan. The underwriting & risk management team also prequalifies companies before staff can access consumer loans.

The Group's operational risk is managed through the use of policies and controls implemented and monitored by the risk management and internal control unit and the use of enterprise software applications for critical business processes. CSPG maintains client information on the Microsoft Office 365 cloud storage solution while other work documents are stored on the local server which is backed up daily. The Infoware enterprise software has disaster recovery and business continuity solutions provided by the vendor while high availability setups and in-house backup solutions are used for all other enterprise and proprietary applications. An internal audit exercise, reviewing the processes and controls of each of CSPG's businesses, is conducted at least once every year by the audit team at the group level.

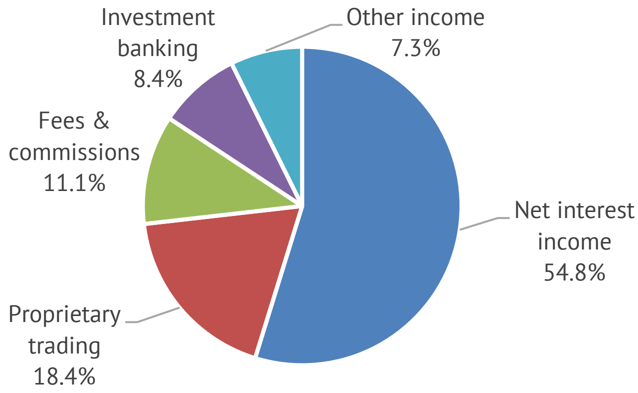
CSPG is in the process of implementing an Enterprise Risk Management (ERM) framework which will have the Group's Board of Directors represented at the helm by a Board Risk Management Committee (BRMC) comprising executive and non-executive directors. The BRMC will be supported by management committees including a Credit Review Committee, Asset & Liability Management Committee and Internal Audit & Risk Management Committee. These committees will be responsible for managing credit exposures related to settlement, lending and investment activities; establishing standards and policies with regards to market risks; and monitoring compliance with policies and procedures and also reviewing the adequacy of the risk management framework respectively. The framework has been partially implemented, however, there is no date set for the completion of the phased implementation. We note that the consumer lending business, which is regulated by CBN, has implemented the ERM framework in line with guidelines.

In our opinion, CSPG's risk management can be improved with more dedicated capacity and greater integration in the businesses' decision-making processes. Some constraints imposed by some of the Group's manuals such as the Proprietary Trading Policy are regularly bypassed with the use of exceptional approvals. In our view, with a more robust risk management in place, the concentration observed in various asset classes and exposure to related parties would be limited.

EARNINGS

During the financial year ended (FYE) 31 December 2019, CSPG generated net earnings of ₦2.9 billion, which represented a 51% growth from ₦2 billion in the prior year. Net interest income from the interest-bearing assets of all the Group's business lines constituted the largest fraction of net earnings at 54.8% or ₦1.6 billion during the period under review. Gains from CSPG's proprietary portfolio accounted for the second largest share of net earnings at 18.4% or ₦546 million in 2019 while fees & commissions from the registrar and securities trading businesses was the third largest contributor with 11.1% or ₦329 million. Fees from the investment banking business were fourth largest with 8.4% of net earnings or ₦249 million in 2019 while other income largely comprising exchange rate gains, dividend income and portfolio management fees accounted for the remainder 7.3%.

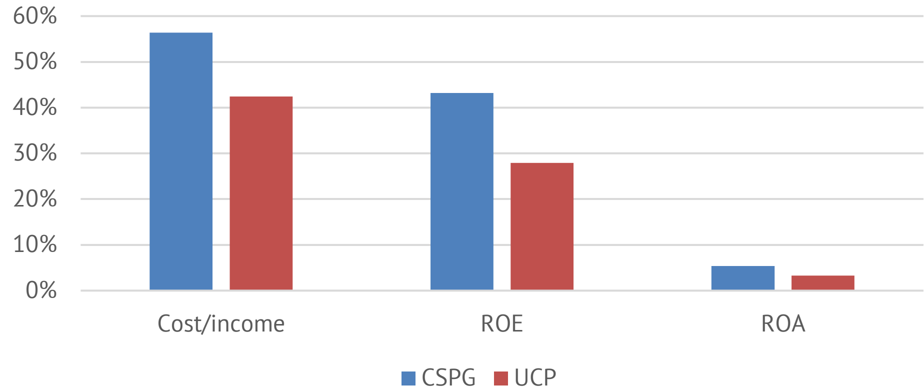
Figure 3: Net earnings by source



Source: CardinalStone Partners Limited

The growth in the Group's net earnings in the period under review was largely due to the increases in net interest income, gains from proprietary trading and fees from the provision of investment banking services. The increase in CSPG's net interest income was in turn driven by growth in the loan book and clients' AuM as the businesses expanded and the rise in proprietary funds following an equity raise during the review period. The increase in gains from proprietary trading was largely driven by successful bets on equities listed on the Nigerian Stock Exchange while the uptick in investment banking fees was recorded following a flurry of capital raising activities in the focus segment of mid-sized companies. We expect the Group's earnings to be supported by the drive for increased AuM and loans in 2020 but to decline moderately due to the challenging domestic and global macroeconomic environments with the capital market and interest rates set to remain subdued.

Figure 4: Group Profitability Indicators (2019)



Source: CardinalStone Partners Limited, United Capital Plc

During the FYE 31 December 2019, CSPG recorded a net interest margin of 55% which was an improvement on the previous year's margin of 50%. The improved net interest margin was due to relatively lower interest-bearing liabilities as equity played a greater role in the funding of the Group's interest generating assets. CSPG also recorded an improved cost to income ratio during the review period of 56.4%, down from 68.7% in the prior period due to the significant growth in net earnings but modest rise in operating expenses. The Group's cost to income ratio was, however, higher than the 42.4% recorded by peer United Capital Group ('UCG'), which runs a leaner operation. CSPG's profit before tax grew by 110% to ₦1.3 billion, leading to improved pre-tax return on average equity (ROE) of 43.2% (2018: 33.1%) and pre-tax return on average assets (ROA) of 5.4% (2018: 3.2%), outperforming peer UCG's pre-tax ROE and ROA ratios of 27.9% and 3.3% respectively in 2019.

The Group's cost to income ratio would deteriorate to 67.1% should the 2019 numbers be adjusted for an impairment charge that covers 100% of the non-performing consumer and structured finance loans in the review period. CSPG's profit before tax would also decline to ₦749 million in 2019. However, the pre-tax return on average equity and pre-tax return on average assets would remain above peer UCG's ratios at 34.4% and 4.4% respectively.

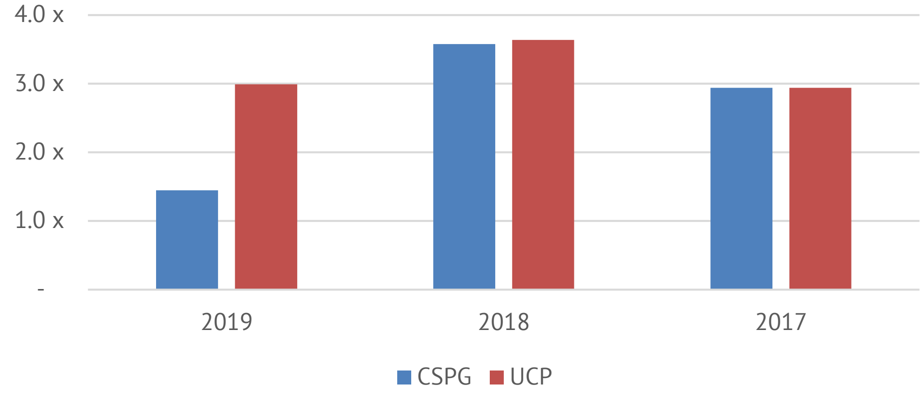
In our opinion, CSPG's profitability is good. The Group has recorded a profit before tax of ₦336 million in the first five months of 2019 based on the unaudited figures. This equates to lower annualised pre-tax return on equity and pre-tax return on assets of 17.7% and 2.8% respectively for 2020. We believe that with the exception of consumer lending, CSPG's businesses have the client base and experience to weather the COVID-19 storm in 2020.

Capital Adequacy & Leverage

As at 31 December 2019, CSPG' shareholders' funds stood at ₦4.3 billion, a 159% growth from ₦1.7 billion in the prior year largely due to an equity issuance to existing and new shareholders. The Group's shareholders' equity included minority interest of ₦459 million, the bulk of which was accounted for by the third-party ownership in the registrar business. Each of CSPG's businesses has sufficient shareholders' funds to meet the regulatory minimum capital requirement for the respective capital or financial market operator licences during the review period.

As at 31 December 2019, the Group's core capital funded 16% of total assets while the (Basel I) adjusted capital to risk weighted assets ratio stood at 28%, which was better than our benchmark. The core capital and adjusted capital ratios were even stronger for CSPG's individual entities with the exception of CS Advance Finance Company, which posted an adjusted capital to risk weighted assets ratio of 19% in 2019. We believe that as the consumer lending grows rapidly, the business' capital must be continuously reinforced to ensure it does not contribute disproportionately to the Group's risk profile.

Figure 5: Group Debt to Equity Ratio



Source: CardinalStone Partners Limited, United Capital Plc

As at 31 December 2019, CSPG had total liabilities of ₦6.3 billion, a moderate 5% increase from the prior year's figure of ₦6 billion. The Group's total liabilities were 11% interest bearing (comprising bank borrowings) and 89% non-interest bearing (largely balances on stock broking clients' accounts). CSPG's debt to equity ratio was low at 1.45 times, better than our benchmark of 3x and peer UCG's ratio of 3x. The Group's net debt as a percentage of average total assets at 52% in 2019 was also better peer UCG's ratio of 56% at the end of the same period.

In our opinion, CSPG's capital adequacy is acceptable and leverage is low.

FUNDING AND LIQUIDITY

As at 31 December 2019, CSPG's total assets were funded 60% by clients' funds under management, 23% by liabilities and 16% by shareholders' funds. The Group's clients' funds under management of ₦16.1 billion comprised term deposits in local currency (52%) and foreign currency (21%) and FGN T-bill investments (27%) of more than 340 individuals and organisations. There was some concentration in the funding base with the top 20 clients accounting for more than 50% of clients' funds management. CSPG's pays a (guaranteed) fixed interest rate on the term deposits which is calculated by marking up a relevant benchmark agreed with each client. The maturities of clients' local currency (LCY) and foreign currency (FCY) deposits are relatively longer tenured with 10.1% maturing in 90 days or less, 11.5% in 91 to 180 days and 78.4% in 181 to 366 days. Of the other liabilities funding the Group, 47% were due in a year or less while 53% were due in more than one year.

As at 31 December 2019, the Group had short-term and highly liquid assets totalling ₦14.8 billion, comprising treasury bills, money market placements and cash. This amount was sufficient to cover the total of ₦9.1 billion of clients' fund under management and other liabilities due within one year. CSPG had FCY assets comprising Eurobonds and money market placements of ₦3.5 billion and FCY liabilities comprising clients' deposits of

₦3.4 billion, resulting in a net asset position of ₦0.1 billion in foreign currency as at the end of the review period. The Group had a total of ₦20.6 billion in liquid assets, enough to cover 87% of total liabilities as at 31 December 2019. CSPG recorded a liquid assets to total assets ratio of 73%, which was better than the 60% prescribed by SEC for capital market operators. The Group had a ₦2 billion trading line that was provided by two Nigerian banks. The line was closed before the 2019 financial year end trading along with the trading positions.

In our opinion, CSPG has a good liquidity and funding profile.

OWNERSHIP, MANAGEMENT & STAFF

CSPG was co-founded by Messrs Femi Ogunjimi, Michael Nzewi, Mohammed Garuba and Mr Yomi Jemibewon, who jointly own 40.7% of the Group's controlling interest via investment company CardinalStone Limited. The other major shareholders of CSPG are Bridgehampton Integrated Service Limited, Ifenwona Investments Limited, Mr Fola Adeola and Chizzy Nigeria Limited who own 16.8%, 8.3%, 8.2% and 5.2% respectively. The remainder 20.8% of the Group is held by 10 other individuals and organisations. We believe that the ownership of the Group is well diversified with no single investor holding a majority stake.

As at 31 December 2019, CSPG had a seven-member Board, who jointly owned (directly and indirectly) 48.9% of the Group. The Board of Directors, which includes the four co-founders, comprises two executive and five non-executive (including two independent) directors and is chaired by Mr Fola Adeola. The Board has two committees: the Finance, Credit & Risk Management Committee and Corporate Governance Committee, with both committees chaired by an independent director. We believe the composition of CSPG's Board and standing committees strong with a good mix of non-executive and independent directors. However, given the Group's size and growth plans we believe the Board requires more breath.

CSPG's Managing Director/CEO, Mr Nzewi, is supported by an Executive Director, Mr Garuba, who doubles as the Managing Director of the asset management business, along with the Heads of the investment banking and proprietary trading business. The three subsidiary businesses: registrars, securities trading and consumer lending, are led by a Chief Business Strategist, Managing Director and Acting Managing Director respectively. In our view, the Group's executive management team has significant capacity with an average of over 20 years of experience in the financial services industry.

Table 5: Staff Productivity (2019)

Entity	CSPG	UCG
Average number of employees	145	99
Staff cost per employee (₦'000)	5,643	16,481
Net earnings per staff (₦'000)	20,458	86,787
Net earnings/staff cost	3.6x	5.3x

Source: CardinalStone Partners Limited, United Capital Plc

During the financial year ended 31 December 2019, CSPG had an average staff strength of 145 employees (2018: 112), of which the executive, management, senior and junior levels accounted for 3%, 24%, 17% and 56% respectively. The Group's staff productivity measured as net earnings per staff was ₦20.5 million in 2019, significantly lower than peer UCG's average of ₦86.8 million in the same period. CSPG's net earnings in 2019 covered staff costs 3.6 times, which was lower than the 5.3x recorded by peer UCG in the period under review.

In our opinion, the Group's management are well qualified and experienced. However, staff productivity can be improved.

OUTLOOK

The COVID-19 pandemic has brought with it a significant amount of uncertainty to every part of the world and Nigeria is no exception. The global oil market and by the extension the Nigerian economy had already started showing signs of heading towards difficulties in the early part of 2020 as the growth in crude oil demand continued to falter and with the members at the heart of the OPEC+ agreement at a deadlock on the required action. The lockdowns around the world due to the pandemic accelerated and amplified the demand challenges with the OPEC basket price falling to just $12.22 per barrel in April 2020. OPEC+ agreed to cut output by an equivalent of 10% of the pre-pandemic crude oil demand from May 2020. This, along with the gradual easing of lockdowns around the world, offers some salvage hopes for the crude oil market and the Nigerian economy in 2020, as long as there is no second deadly wave of COVID-19 infections.

The effects of the global and domestic uncertainties have manifested in the Nigerian economy in the usual ways with significant devaluation of the naira in the official and parallel markets witnessed in the first half of 2020. At such low crude oil prices, the devaluation of the naira is unlikely to sufficiently compensate for the drop in the nation's crude oil receipts and thus many of the state governments may struggle to meet salaries and other obligations. This slowdown will have a negative impact on the wider business community and credit markets leading to further contraction of the economy and financial markets uncertainty in Nigeria. Domestic borrowing requirements of the central government is set to rise putting upward pressure on interest rates. This will, however, be tempered by the expected flight to safety of investors. Notwithstanding, the second half of 2020 is poised to offer improved prospects with the gradual easing of lockdowns and OPEC+ cuts.

Agusto & Co. expects CSPG's businesses to cope reasonably well under the challenges of 2020. The Group's asset management business in particular is likely to benefit with dollar investments gaining in value and more investors looking to protect capital while earning returns. However, the exposure to credit risk will be more acute now especially on the foreign currency investments. The consumer lending business will require special attention as medium to low income households, who are one of the quickest hit, will be one of the slowest to recover. The investment banking business is also expected to witness an uptick in the second half the year as businesses seek capital to rebuild reserves and reinvigorate business activities. We believe that the registrar and securities trading businesses have the client base and experience to weather the storm until the expected improvement in the second half of the year.

We hereby attach a "stable" outlook to the rating.

FINANCIAL SUMMARY

STATEMENT OF FINANCIAL POSITION AS AT	31-Dec-19		31-Dec-18		31-Dec-17	
	=N='000		=N='000		=N='000	
ASSETS						
Cash & bank balances	1,915,965	7.2%	1,166,477	5.5%	2,023,431	11.6%
Short term investments	11,520,731	43.1%	12,168,336	57.5%	9,274,683	53.3%
Direct loans & advances - net	3,823,876	14.3%	1,371,328	6.5%	1,062,943	6.1%
Advances under finance leases - net	-	0.0%	-	0.0%	-	0.0%
Total loans (net)	3,579,656	13.4%	1,371,328	6.5%	1,062,943	6.1%
Total other assets	2,573,668	9.6%	3,466,169	16.4%	2,368,190	13.6%
Funds under management (FUM)	6,031,690	22.6%	2,585,195	12.2%	2,518,606	14.5%
Total other long term investments	550,000	2.1%	0	0.0%	0	0.0%
Total fixed assets & intangibles	560,582	2.1%	407,633	1.9%	155,039	0.9%
TOTAL ASSETS	**26,732,292**	**100.0%**	**21,165,138**	**100.0%**	**17,402,892**	**100.0%**
LIABILITIES & EQUITY	**=N='000**		**=N='000**		**=N='000**	
Total interest bearing liabilities	661,388	2.5%	609,677	2.9%	257,674	1.5%
Total other liabilities	5,604,788	21.0%	5,361,256	25.3%	5,721,290	32.9%
Funds under management (FUM)	16,143,549	60.4%	13,524,624	63.9%	9,387,113.00	53.9%
Total liabilities	22,409,725	83.8%	19,495,557	92.1%	15,366,077	88.3%
Share Capital	317,842	1.2%	250,000	1.2%	250,000	1.4%
Share Premium	2,183,447	8.2%	242,500	1.1%	242,500.00	1.4%
Statutory Reserve	2,934.00	0.0%	-	0.0%	1,271.00	0.0%
Irredeemable Debentures	458,667.00	1.7%	387,968	1.8%	441,557.00	2.5%
Revaluation Surplus	(5,174.00)	0.0%	(5,606)	0.0%	(15,383.00)	-0.1%
Bonus Issue Reserve	-	0.0%	-	0.0%	-	0.0%
Other Non-distributable Reserves	0	0.0%	0	0.0%	-	0.0%
Revenue Reserve	1,364,851	5.1%	794,719	3.8%	1,116,870	6.4%
Shareholders' equity	4,322,567	16.2%	1,669,581	7.9%	2,036,815	11.7%
TOTAL LIABILITIES & EQUITY	**26,732,292**	**100%**	**21,165,138**	**100%**	**17,402,892**	**100%**

INCOME STATEMENT FOR THE YEAR ENDED	31-Dec-19		31-Dec-18		31-Dec-17	
	=N='000		=N='000		=N='000	
Portfolio Management	38,653	0.9%	90,078	2.9%	63,809	2.2%
Securities Trading & Dealing	546,382	12.7%	(10,707)	-0.4%	458,777	16.0%
Financial Advisory	249,354	5.8%	117,431	3.8%	92,088	3.2%
Fees & Commissions	328,971	7.7%	374,939	12.3%	378,496	13.2%
Other income	178,266	4.1%	292,041	9.6%	301,463	10.5%
Investment income	1,341,626	31.2%	863,782	28%	1,294,633	45%
Interest income	2,955,747	68.8%	2,193,699		1,570,383	
Interest expense - clients	-1,330,940	-31.0%	-1,094,021	-35.8%	(709,250)	-24.8%
Net interest income	1,624,807		1,099,678		861,133.00	
Net earnings	2,966,433		1,963,460		2,155,766	
Staff costs	(818,172)	-19.0%	(702,161)	-23%	(576,751)	-20%
Depreciation expense	(70,921)	-1.7%	(66,612)	-2%	(57,705)	-2%
Other operating expenses	(783,342)	-18.2%	(580,972)	-19%	(498,171)	-17%
Total operating expenses	(1,672,435)	-38.9%	(1,349,745)	-44%	(1,132,627)	-40%
Profit (loss) before taxation	1,293,998	30.1%	613,715	20%	1,023,139	36%
Tax (expense)/benefit	(226,819)	-5.3%	(351,746)	-12%	(144,199)	-5%
Profit (loss) after taxation	1,067,179	24.8%	261,969	9%	878,940	31%
Non -operating income (expense) - net						
Statutory reserve						
Capital redemption						
Proposed dividends	(400,000)	-9%	(400,000.00)	-13%	(150,000.00)	-5%
Script issues						
Other appropriations/adjustments	(97,047)	-2.3%	-184,120	-6%	-111,147	-4%
Retained profit	570,132		(322,248)		617,793	
Profit retained b/fwd	794,719		(856,117)		(1,473,910)	
Profit retained c/fwd	1,364,851		(1,178,365)		(856,117)	
Gross earnings	4,297,373		3,057,481		2,865,016	
AUDITORS	PKF		PKF		PKF	
OPINION	CLEAN		CLEAN		CLEAN	

KEY RATIOS	31-Dec-19	31-Dec-18	31-Dec-17
PROFITABILITY			
Revenue Growth	51.1%	-8.9%	60.1%
Operating profit margin	30.1%	20.1%	35.7%
Operating expenses/ net earnings	56.4%	68.7%	52.5%
Return on average equity (pre-tax)	43.2%	33.1%	60.1%
Return on average assets (pre-tax)	5.4%	3.2%	6.7%
Gross earnings/Total assets & contingents (average)	17.9%	15.9%	18.8%
LIQUIDITY & FUNDING			
Liquid assets/total assets	73%	75%	79%
Liquid assets/short term IBD	5833%	3568%	9867%
Liquid assets/Managed funds	120%	117%	147%
Adjusted capital & long term debt/illiquid assets	437%	478%	1520%
CAPITAL & LEVERAGE			
Adjusted capital/risk weighted assets	28%	16%	30%
Gross debt/equity (times)	1.4	3.6	2.9
Gross debt/Adjusted equity (times)	6.0	11.8	7.5
IBD (net of cash) as % of equity without revaluation	-295%	-760%	-538%
IBD (net of cash) as % of adjusted capital	-42%	-44%	-92%
Interest cover	1	1	2
STAFF INFORMATION			
Average number of employees	145	112	103
Staff cost per employee (N'000)	5,643	6,269	5,600
Net earnings per staff (N'000)	20,458	17,531	20,930
Staff cost/Net earnings	28%	36%	27%
Staff costs/Operating expenses	49%	52%	51%
OTHER KEY INFORMATION			
Year operations started	2008	2008	2008
Age (in years)	11	10	9
Number of offices	6	6	6

Rating Definitions

Aaa	A financial institution of impeccable financial condition and overwhelming capacity to meet obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) are unlikely to lead to deterioration in financial condition or an impairment of the ability to meet its obligations as and when they fall due. In our opinion, regulatory and/or shareholder support will be obtained, if required.
Aa	A financial institution of very good financial condition and strong capacity to meet its obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a slight increase the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain strong. Although regulatory support is not assured, shareholder support will be obtained, if required.
A	A financial institution of good financial condition and strong capacity to meet its obligations. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain largely unchanged. In our opinion, shareholder support should be obtainable, if required.
Bbb	A financial institution of satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due. It may have one major weakness which, if addressed, should not impair its ability to meet obligations as and when due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution.
Bb	Financial condition is satisfactory and ability to meet obligations as and when they fall due exists. May have one or more major weaknesses. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
B	Financial condition is weak but obligations are still being met as and when they fall due. Has more than one major weakness and may require external support, which, in our opinion, is not assured. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
C	Financial condition is very weak. Net worth is likely to be negative and obligations may already be in default.
D	In default.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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