GCR RATINGS

Credit Rating Announcement

GCR affirms CardinalStone Partners Limited's national scale long and short-term issuer ratings of BBB-(NG)/A3(NG); Outlook revised to Positive from Stable

Rating Action

Lagos, 18 October 2022 - GCR Ratings ("GCR") has affirmed CardinalStone Partners Limited's ("CardinalStone" or "the Group") national scale long and short-term issuer ratings of BBB-(NG) and A3(NG) respectively; with the outlook revised to Positive from Stable.

Rated Entity	Rating class	Rating scale	Rating	Outlook
CardinalStone Partners Limited	Long Term Issuer	National	BBB-(NG)	Positive Outlook
	Short Term Issuer	National	A3(NG)	

Rating Rationale

The positive outlook on CardinalStone reflects its expanding operational scale, good earnings profile, and sound leverage and cash flow position. However, these strengths are partly offset by the elevated risk profile, characterised by sizeable market-sensitive income and the increasing non-performing loans ("NPL") ratio.

CardinalStone is a diversified financial service group, with operations spread across the Nigerian financial services industry and a track record of over a decade. The Group has continued to focus on its strategic plan of growth and expansion, aimed at strengthening competitive positioning across its business lines. In this regard, two new subsidiaries (CardinalStone Trustees Limited and CardinalStone Asset Management Limited) commenced operations in 2021, thereby increasing subsidiary count to five. CardinalStone has over the years created a niche for its various subsidiaries, through which it offers an array of services such as consumer finance, financial advisory, asset management, trusteeship, share registration, and securities trading. However, this is balanced against its relatively modest market share within the Nigerian financial services industry.

Though GCR considers CardinalStone's earnings to be strong, this is counterbalanced by the elevated risk profile, particularly market and credit risk. While the Group consistently displayed a robust EBITDA margin (averaging c.90%) over the review period, GCR negatively viewed the quality of earnings, given that a significant portion of total revenue was generated through the highly volatile market-sensitive instruments (equity trading). In FY21, market-sensitive income constituted a sizeable 51.4% of gross revenue (FY20: 51.0%), albeit moderated to 28.5% in June 2022. Going forward, a better earnings mix is envisaged on the back of CardinalStone's concerted efforts at increasing the proportion of the relatively stable fees-based income. Also, asset quality metrics (NPL ratio and credit losses) remained pressured over the last three years due to the impact of the pandemic and macroeconomic challenges. As a result, the NPL ratio evidenced an upward trend to 7.9% as at 30 June 2022 (FY21: 7.3%: FY20: 4.3%), while credit losses registered at 2.1% (FY21: 2.5%). Credit risk is further heightened by a loan book dominated by uncollateralised exposures.

Leverage and cash flow is a positive ratings factor, underpinned by the relatively low gearing level, with net debt to EBITDA at 1.1x as at 30 June 2022 (FY21: 0.8x; FY20: 0.6x). However, this is partly offset by the high finance cost relative to the operational cash flow generation during the period. In this regard, EBITDA coverage of interest expenses remained low at 3.6x in June 2022 (FY21: 3.0x; FY20: 2.9x). While we expect a further increase in debt as CardinalStone continues to exploit funding options to meet the increasing funding needs, the low gearing level is anticipated to be maintained over the rating horizon, predicated on good cashflow generation capacity.

CardinalStone's liquidity assessment is sound, with the liquidity sources consistently covering the anticipated uses by over 1x over the review period, registering at 1.5x as at 30 June 2022 (FY21: 2.0x; FY20: 1.6x). This is largely underpinned by good cash flow generation and liquid balance sheet, which was further augmented by the N10bn commercial papers issued in the first half of 2022. Going forward, liquidity sources versus uses coverage is expected to be sustained at a similar range, due to the maintenance of adequate levels of liquid investment securities.

Outlook Statement

The positive outlook reflects GCR's expectations that CardinalStone's increased business offerings through the new subsidiaries will enhance its operational scale and competitiveness within the Nigerian financial services segment. We also expect EBITDA margin to remain strong within the historical range, with a better earnings mix, particularly in view of efforts to increase fees-based income. We believe good cash flow generation and a liquid balance sheet will continue to support sound liquidity coverage over the ratings horizon.

Rating Triggers

A ratings upgrade could stem from further improvement in competitive position and earnings diversification, while also maintaining liquidity coverage above 2x on a sustainable basis. Conversely, downward ratings movement could be triggered by increased market-sensitive income and a material deterioration in asset quality, earnings and liquidity metrics.

Analytical Contacts

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Related Criteria and Research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Financial Service Companies, January 2022
GCR Ratings Scale, Symbols & Definitions, May 2022
GCR Country Risk Scores, August 2022
GCR Financial Institutions Sector Risk Score, June 2022

Ratings History

CardinalStone Partners Limited					
Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial	National	BBB-(NG)	Stable	June 2020
Short Term Issuer	Initial	National	A3(NG)		
Long Term Issuer	Last	National	BBB-(NG)	Stable	September 2021
Short Term Issuer	Last	National	A3(NG)		

Risk Score Summary

Rating Components & Factors	Risk scores
Operating environment	**5.75**
Country risk score	3.75
Sector risk score	2.00
Business profile	**(2.00)**
Competitive position	(2.00)
Management and governance	0.00
Financial profile	**2.50**
Cashflow and leverage	2.00
Earnings vs. Risk	0.00
Liquidity	0.50
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**6.25**

Glossary

Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
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.
Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
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.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Coverage	The scope of the protection provided under a contract of insurance.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Credit	A contractual agreement in which a borrower receives something of value now, and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company

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 indvdual or company's vulnerability to varous risks
Gearing	Gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
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.
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.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Loss	1. A tangible or intangible, financial or non-financial loss of economic value. 2. The happening of the event for which insurance pays (insurance).
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.
Offset	A right (Right of Offset) to set liabilities against assets in any dispute over claims.
Option	An option gives the buyer or holder the right, but not the obligation, to buy or sell an underlying financial asset at a pre-determined price.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Performing	An obligation that performs according to its contractual obligations.
Rating Horizon	The rating outlook period

Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Securities	Various instruments used in the capital market to raise funds.
Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Trust	A third party that acts in the best interest of another party, according to the trust deed, usually the investors. Owner of a securitisation vehicle that acts in the best interest of the Noteholders.
Trustee	An individual or firm that holds or administers property or assets for the benefit of a third party.
Upgrade	The rating has been raised on its specific scale.

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 rating has been disclosed to CardinalStone Partners 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 rating.

CardinalStone Partners 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 CardinalStone Partners Limited and other reliable third parties to accord the credit ratings included:

- Audited financial results as at 31 December 2021
- Four years of comparative audited numbers
- Management accounts as at 30 June 2022
- Other related documents.