

CREDIT RATING ANNOUNCEMENT

GCR affirms Nova Merchant Bank Limited's National Scale Long and Short-term Issuer Ratings of BBB_(NG)/A3_(NG); Outlook Stable

Rating action

Lagos, 27 June 2023 – GCR Ratings (GCR) has affirmed Nova Merchant Bank Limited's (Nova MB or the bank) national scale long and short-term ratings of BBB_(NG) and A3_(NG) respectively, 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 affirmation of Nova Merchant Bank Limited's (Nova MB or the bank) ratings reflects its good asset quality, stable funding and liquidity structure and improved competitive position (although modest). However, these strengths are offset by concentration in the loan portfolio, the dominance of market-sensitive income and increased credit risks relating to defaults on some off-balance sheet exposures.

Nova MB operates within the Nigerian merchant banking subsector and provides a broad range of financial services and bespoke solutions to high-net-worth individuals and public and private businesses. Services offered include corporate and investment banking, money market activities, wealth management and advisory services. The bank registered a year-on-year growth of 14.6%, 9.3% and 30.0% in total assets, gross loans, and customer deposits respectively in the financial year ended 31 December 2022, despite the prevalent challenges in the operating environment. Similarly, the bank's operating revenue rose by 42.8% in the same year following a decline in the preceding year. However, Nova MB's competitive position is constrained by limited geographical diversification, a concentrated customer base, a low market share of the banking industry's resources and a relatively short track record. Looking ahead, we expect the market share and competitive position to improve underpinned by the bank's expansion plans. Our assessment of Nova MB management and governance is neutral to the rating.

Nova MB's risk position is largely well contained, although we note some deterioration in the Bank's off-balance sheet commitments in the year under review. While the NPL ratio of the loan book remained low at 0.2% in 2022 (2021: 0.4%) and the credit loss ratio maintained historic low levels of below 0.5%, there were migrations in the off-balance sheet commitments to stages 2 and 3 buckets from the stage 1 bucket. When stage 3 off-balance sheet commitments are included, the bank's NPL ratio deteriorates to 1.7% in 2022, though still less than the regulatory threshold of 5%. Nova MB's stage 3 off-balance-sheet commitments comprise matured letters of credit obligations that are outstanding because adverse movements in exchange rates reduced the coverage of naira collaterals. These obligations are expected to be converted

to on-balance sheet loans and serviced over time. Concentration risk persists, with the top twenty obligors accounting for a higher 84.8% (2021:64.9%) of the loan book as of 31 December 2022. We consider the bank's foreign currency (FCY) exposure to be moderate, as 24.3% of the loan portfolio was FCY denominated as of 31 December 2022 (2021: 25.2%) and is naturally hedged. Looking ahead, we expect asset quality metrics to remain within the regulatory limits, although the recent naira devaluation will pressure unsecured off-balance sheet commitments.

Capitalisation is assessed to be intermediate. Over the years, Nova MB has maintained a capital adequacy ratio (CAR) above the 10% regulatory limit for merchant banks. Nonetheless, the bank's GCR core capital ratio has moderated over the review period from 31% in 2020 to 19.0% in the financial year end 31 December 2022 (31 December 2021: 24.0%) as the growth in risk-weighted assets (RWA) continued to outpace internal capital generation. Although the bank's loan loss reserve to stage 3 loans improved to 23.7% in 2022 (2021:12.1%), the coverage of impaired on and off-balance sheet commitments is low. In addition, Nova MB's earnings base is dominated by highly volatile market-sensitive income, which contributed 64.8% to total revenue in the financial year 2022 (2021: 77.0%). Over the next 12-18 months, we expect the bank's GCR core capital ratio to range between 15% and 25% on account of the loan growth and the naira devaluation. We could lower the capitalisation assessment should the GCR core capital ratio reduce further.

Nova MB's funding and liquidity is a positive ratings factor. In 2022, customers' deposits grew by 30.0% (2021:30.4%) but remained dominated by wholesale funds which accounted for 99.8% of the funding base as of 31 December 2022 (31 December 2021: 99.6%). In a bid to augment its funding sources, the bank issued a NGN12bn commercial paper in the year under review, which was repaid before 31 December 2022. The bank's 20 largest single-name depositors collectively accounted for 63.4% (2021: 76.5%) of the total customer deposits in 2022, revealing some diversification in the depositor base. Notwithstanding, cognisance is taken of the improved core deposits to funding base and long-term funding ratios which registered at 80.31% (2021:75.9%) and 93.70% (2021:90.6%) respectively, comparing well with peers. Nova MB continues to maintain a strong liquid profile as GCR liquid assets coverage of customer deposits and GCR liquid assets coverage of wholesale funding registered at 29.6% (2021:33.6%) and 5.2x (2021: 4.7x) respectively. We expect this position to be sustained over the rating horizon.

Outlook statement

The stable outlook reflects our expectation that the funding and liquidity position will be sustained at sound levels over the next 12-18 months. Similarly, we expect an improvement in capital metrics, underpinned by firmer earnings while asset quality metrics should remain within regulatory limits and compare favourably with peers.

Rating triggers

The assigned ratings could be reviewed upward if there is a sustained improvement in capitalisation and asset quality metrics, while also achieving further loan book diversification. Conversely, the ratings could be downgraded if there is a deterioration in the bank's asset quality metrics (especially from the off-balance

sheet commitments), a loss in market share or a decline in the GCR core capital ratio below current levels over the next 12-18 months.

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Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, May 2023
GCR Financial Institutions Sector Risk Score, April 2023

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	May 2021
Short Term issuer	Last	National	A3 _(NG)		May 2021
Long Term Issuer	Last	National	BBB _(NG)	Stable Outlook	June 2022
Short Term Issuer	Last	National	A3 _(NG)		June 2022

Risk score summary

Rating Components & Factors	Risk Scores
Operating environment	7.00
Country risk score	3.50
Sector risk score	3.50
Business profile	(2.00)
Competitive position	(2.00)
Management and governance	0.00
Financial profile	1.25
Capital and Leverage	0.75
Risk	0.25
Funding and Liquidity	0.25
Comparative profile	0.00
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	6.25

Glossary

Accounting	A process of recording, summarising, and allocating all items of income and expense of the company and analysing, verifying and reporting the results.
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.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital Base	The issued capital of a company, plus reserves and retained profits.
Capital Markets	The part of a financial system concerned with raising capital by dealing in shares, bonds, and other long-term debt securities.
Capital	The sum of money that is invested to generate proceeds.
Capitalisation	The provision of capital for a company, or the conversion of income or assets into capital.
Commercial Paper	Commercial paper is a negotiable instrument with a maturity of less than one year.
Core Deposits	That portion of a bank's deposits that is relatively stable and has a predictable cost. Deposits fluctuate seasonally and cyclically, but even in adverse circumstances, deposits normally do not fall below some minimum level.
Coverage	The scope of the protection provided under a contract of insurance.
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
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Financial Year	The year used for accounting purposes by a company or government. It can be a calendar year or it can cover a different period, often starting in April, July or October. It can also be referred to as the fiscal year.
Income	Money received, especially on a regular basis, for work or through investments.
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).
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Obligor	The party indebted or the person making repayments for its borrowings.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Revaluation	Formal upward or downward adjustment to assets such as property or plant and equipment.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.

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 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 the 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 2022
- Other related documents.

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