

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 2024 – GCR Ratings (GCR) has affirmed Nova Merchant Bank Limited's 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
Nova Merchant Bank Limited	Long Term Issuer	National	BBB _(NG)	Stable
	Short Term Issuer	National	A3 _(NG)	

Rating rationale

The rating affirmation on Nova Merchant Bank Limited (Nova MB or the bank) reflects adequate capitalisation metrics, a risk position that is broadly within the average range of the industry as well as a stable funding and liquidity position. These strengths are however offset by the weaker earnings quality, limited geographical diversification, and concentrated customer base.

Nova MB has grown steadily over the years, registering a five-year CAGR of 67.3% in total assets to NGN327.4 billion (\$364.1 million) in the financial year ended 31 December 2023. The bank controlled an estimated 18%, 21%, and 25% of the merchant banking subsector's total assets, gross loans, and customer deposits respectively in 2023. However, its contribution to the broader banking industry remained less than 1%. During the first quarter of 2024, Nova MB received an approval-in-principle from the Central Bank of Nigeria for a commercial banking licence. Therefore, the bank's anticipated transition to a full-fledged commercial bank could enhance its competitive position, over the longer term, through an improved market share diversified operations, and lower funding costs. Our assessment of Nova MB's sustainability is neutral to the rating.

Capitalisation is adequate for the bank's operations. Following a sustained moderation in Nova MB's GCR core capital ratio from 30.9% in 2020 to 19% in 2022, the metric increased to 23.8% as of 31 December 2023 and further to 28.5% as of Q1, 2024 on account of a decline in risk-weighted assets (RWA), following the settlement of outstanding matured letters of credit obligations, and continuous growth in qualifying capital. Nova MB's shareholders' equity strengthened to NGN32.3 billion in the first quarter of 2024 (2023: NGN29.8 billion), following the capital injection of NGN1.4 billion through a rights issue as well as the impact of earnings accretion. With the regulatory-induced recapitalisation of the Nigerian banking sector, Nova MB plans to raise additional equity capital of over NGN160 billion through a combination of rights issue, private

placement, and an initial public offer (IPO) within the two-year timeframe (2024-2026) to meet the new capital requirements for the commercial banking license.

We consider Nova MB's transition to a commercial bank vital for the quality of earnings and capital over the next 12-18 months given that income from the core lending business was pressured in the first five months of 2024 by a faster repricing of liabilities (largely wholesale customer deposits) compared to assets following the successive hikes in the Monetary Policy Rate (MPR) in 2024. Earnings quality remains a drag on Nova MB's capitalisation metrics. While the bank recorded a pre-tax profit of over NGN 2.0 billion in the five-month period ended 31 May 2024, it reported an overall net interest expense of NGN674.7 million compared to net interest income of NGN1.9 million in 2023 (2022: NGN659.8 million). As a result, market-sensitive income accounted for a significant 82.4% (2023: 53.8%, 2022: 64.8%) of total operating income. With the conversion to a commercial bank, and a managed growth in risk assets compared with internally generated capital, the GCR core capital ratio could range between 23% and 25% over the next 12-18 months, supporting the ratings.

Nova MB's risk position is a positive rating factor underpinned by sound asset quality metrics and a cautious lending approach. Gross loans increased by a moderate 7.4% to NGN 103.9 billion (\$115.5 million) as of 31 December 2023 (2022: NGN 96.7 billion) but declined by 31.1% to NGN71.6 billion (\$48.2 million) as of 31 May 2024. The decline in gross loans is underpinned by paydowns due to the high interest rate environment. Non-performing loans (NPL) and credit loss ratios remained below 0.5%, consistent with the 2022 levels, despite the challenging macroeconomic environment. Concentration risk remained high as the top twenty obligors accounted for 88.7% (2022: 87.0%) of the loan book as of 31 December 2023, a common trend in the merchant banking subsector. Foreign currency exposures were moderate, relative to the industry average, at 34.2% (2022: 24.2%) of gross loans as of 31 December 2023 and are largely naturally hedged. We note positively that the bulk of the outstanding matured letters of credit obligations have been paid by CBN. Looking ahead, while the banking sector's asset quality could be pressured by the weak operating environment, we expect Nova MB's metrics to remain within the regulatory limits.

GCR's assessment of funding and liquidity is positive to the rating. Given the peculiarities in the merchant banking subsector, Nova MB is predominately funded by customers' deposits which are largely interest rate sensitive and wholesale deposits (a minimum of NGN50 million). In 2023, the proportion of price-sensitive term deposits to total deposits registered at a high 91.3%, resulting in a high cost of funds at 10.0%, like other merchant banks. Depositor concentration risk persists as the twenty largest depositors accounted for a higher 85.0% (2022: 63.4% of total customer deposits as of 31 December 2023). Over the next 12-18 months, GCR expects a more diversified depositor base anchored on the mobilisation of more stable low-cost deposits in the event of a successful transition, thus moderating the cost of funds. GCR core deposits to funding base and long-term funding ratios registered at improved levels of 86.3% (2022: 80.3%) and 102.5% (2022: 93.7%) respectively and compares well with peers. Nova MB's balance sheet is liquid. GCR liquid assets coverage of customer deposits and GCR liquid assets coverage of wholesale funding registered at 52.3% (2022: 28.8%) and 8.9x (2022: 5.0x) respectively in 2023.

Outlook statement

The stable outlook reflects our expectation that Nova MB's GCR core capital ratio will be maintained within the 23% to 25.0% range over the next 12-18 months despite the expected growth post the bank's transition to a commercial bank. Similarly, asset quality, funding, and liquidity metrics are expected to be sustained at sound levels.

Rating triggers

The ratings could be reviewed upward if the successful transition to a commercial bank strengthens the competitive position materially (through improved market share and diversification) over the next 12-24 months while sustaining a GCR core capital ratio above 23%. Conversely, the ratings could be downgraded if there is a deterioration in the bank's asset quality and if continued downward pressure on earnings causes the GCR core capital ratio to fall below the 23% to 25% range over the next 12-24 months.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2024

Criteria for Rating Financial Institutions, May 2024

GCR Ratings Scales, Symbols & Definitions, May 2023

GCR Country Risk Scores, June 2024

GCR Financial Institutions Sector Risk Score, April 2023

Ratings history

Nova Merchant Bank Limited

Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial	National	BBB-(NG)	Stable	April 2019
Short Term Issuer		National	A3(NG)	Stable	April 2019
Long Term Issuer	Last	National	BBB(NG)	Stable	June 2023
Short Term Issuer		National	A3(NG)	Stable	June 2023

Risk score summary

Rating Components & Factors	Score
Operating environment	7.00
Country risk score	3.50
Sector risk score	3.50
Business profile	-2.00
Competitive position	-2.00
Sustainability	0.00
Financial profile	1.25
Capital & Leverage	0.75
Risk	0.25
Funding and Liquidity	0.25
Comparative profile	0.00
Group support	0.00
Peer comparison	0.00
Total Risk 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	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
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.
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.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Hedge	A form of risk management aimed at mitigating financial loss or other adverse circumstances. May include taking an offsetting position in addition to an existing position. The correlation between the existing and offsetting position is negative.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
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.

Obligor	The party indebted or the person making repayments for its borrowings.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Private Placement	The sale of securities to a small number of institutional investors such as large banks, insurance companies and pension funds. Such issuances do not require a formal prospectus and are often not listed on an exchange.
Reserve Requirement	Minimum amount of cash or cash equivalents (computed as a percentage of deposits) that banks are required by law to keep on hand, and which may not be used for lending or investing. Reserve requirements serve as a safeguard against a sudden and inordinate demand for withdrawals, and as a control mechanism for injecting cash (liquidity) into, or withdrawing it from, an economy.
Rights Issue	One of the ways that a company can raise additional funds is to issue new shares. These must be first offered to current shareholders and a rights issue allows a shareholder to buy shares in proportion to the number already held.
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 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, Nova Merchant Bank Limited.

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 as at 31 December 2023
- Four years of comparative audited numbers
- Other related documents.
- Exchange rate source: Central Bank of Nigeria USD1.00 = NGN899.39(31 December 2023); USD1.00 = NGN1,482.48 (31 May 2024)

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