Development Bank of Nigeria Plc

Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Development Bank of Nigeria Plc

Rating Assigned:

Aaa

ESG Score:

2

Outlook: Stable
Issue Date: 19 April 2023
Expiry Date: 30 June 2024
Previous Rating: Aaa

Industry: Development Finance Institutions (DFI)

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A development finance institution of very good financial condition and strong capacity to meet its obligations as and when they fall due

RATING RATIONALE

Agusto & Co. affirms the "**Aaa"** rating assigned to the Development Bank of Nigeria Plc ("DBN" or the "Bank"). We have also assigned an ESG Score of "**2**" reflecting the minimal contribution of environmental, social and governance issues to the Bank's credit rating. The rating is backed by the support and profile of the shareholders; the Ministry of Finance Incorporated (MOFI), Nigeria Sovereign Investment Authority (NSIA), African Development Bank (AfDB) and the European Investment Bank (EIB). AfDB and EIB, both rated **Aaa** by Fitch, support the Bank with equity and low-interest, long-term borrowings. These shareholders also provide the technical resources needed to support micro, small and medium-sized enterprises (MSMEs); the target market. Similarly, MOFI facilitated the sovereign guarantee used to secure the Bank's borrowings while also mitigating the associated currency risk. DBN's good asset quality, good capitalisation, good liquidity and experienced management team are also positive rating factors. However, we have also considered Nigeria's weak macroeconomic variables that have adversely impacted the performance of MSMEs.

DBN operates by providing MSMEs in Nigeria with financing, partial credit guarantees and technical assistance through eligible Participating Financial Institutions (PFIs), who in turn carry out on-lending to the MSMEs. During the year under review, the loan book expanded by 15.1% to ₦372.2 billion and the eligible participating financial institutions (PFIs) with credit exposures expanded to 27 (FYE 2021: 20). Notwithstanding the loan growth, all credit exposure remained in the stage 1 category, despite serving the relatively high-risk MSME segment. In our view, the Bank's credit risk management framework will be tested in the near term, given its plans to expand its coverage beyond the pre-existing PFIs to include Private equity firms, FinTech, Non-interest banks and other non-traditional channels.

DBN is well capitalised for current business risks. As at FYE 2022, DBN's shareholders' funds stood at ₦212.2 billion (FYE 2021: ₦192.7 billion) significantly higher than the ₦100 billion regulatory minimum. As at the same date, the capital adequacy ratio (CAR) at 64.3% (FYE 2021: 64.2%) exceeded the 10% threshold for wholesale development finance Institutions. In the same vein, the tier 1 capital to risk weighted assets stood strong at 51.5%. In our view, the capitalisation of DBN is strong and the ability of its shareholders to support the business going forward is not in doubt.

DBN is funded by borrowings from international development partners such as the World Bank, French Development Agency, KfW German Development Bank and AfDB. During the year under review, repayment of borrowings resulted in a marginal 2.3% decline in total borrowings to ₦291.1 billion as at FYE 2022. As a result, the weighted average cost of funds declined by 10 basis points to 3.81% and the debt-to-equity ratio improved to 1.4 times (FYE 2021: 1.6 times). As at FYE 2022, the Bank's liquidity position remained strong as liquid assets represented 45% (FYE 2021: 54%) of total borrowings and 73.1% of near-term obligations (loans yet to be disbursed, planned capital injection into the subsidiary and borrowing repayment over the next 1 year).

DBN's earnings are primarily generated from interest income on loans to eligible PFIs for on lending to MSMEs as well as investments in liquid assets. Although the DBN's core mandate is to achieve its developmental goals, profitability remains a key objective considering its impact on future viability of the Bank. In FY 2022, DBN's pre-tax profits grew by 29.7% to ₦29.5 billion, driven by a larger loan portfolio, a rising yield environment and adjustment of the pricing model to reflect market realities. However, operating expenses increased by 37.5% on the back of business expansion and inflationary pressure, moderating profitability. Overall, pre-tax return on average assets (ROA) and pre-tax return on equity (ROE) increased to 5.8% (FYE 2021: 4.6%) and 14.6% (FYE 2021: 12.3%) respectively. We consider the Bank's profitability to be acceptable for a development finance institution.

Strengths

- Strong support of the Federal Government of Nigeria through the MOFI
- Strong support from other prinicipal shareholders and global partners
- Good asset quality
- Good liquidity
- Strong capitalisation
- Experienced management team

Weakness

- High employee turnover in FYE 2022

Challenges

- Maintaining good asset quality in an adverse operating climate and high susceptibility of MSMEs to weak macroeconomic fundamentals
- Rising operating expenses due to increased inflationary pressure
- Keeping costs of funds low in order to attract the disbursement of loans though the commercial banking PFIs.

Table 1: Financial Information

	31 December 2021	31 December 2022
Total Assets	₦499.2 billion	₦517.2 billion
Operating Income	₦26.8 billion	₦35.1 billion
Pre-tax Return on Average Assets (ROA)	4.6%	5.8%
Pre-tax Return on Average Equity (ROE)	12.3%	14.6%

PROFILE

Development Bank of Nigeria Plc ("DBN" or 'the Bank") was incorporated as a public liability company on 19 September 2014 and was granted a license by the Central Bank of Nigeria (CBN) to operate as a wholesale development finance institution (WDFI) on 29 March 2017. The Bank is jointly owned by the FGN, albeit through the Ministry of Finance Incorporated (59.87%), the Nigeria Sovereign Investment Authority (14.97%), African Development Bank (17.98%) and the European Investment Bank (7.19%). In addition to the equity contributions, the shareholder, AfDB as well as other international global partners such as the International Bank for Reconstruction and Development ("IBRD" or "the World Bank"), Agencie Francaise de developpment ("French Development Agency" or "AFD"), KfW German Development Bank, and the African Development Fund (Fund of the AfDB) collectively collaborate with the FGN to address the financing and capacity deficits confronting Micro, Small and Medium Scale Enterprises (MSMEs), given their significant contribution to the Nigerian economy.

DBN commenced operations on 1 November 2017 and provides financial support to MSMEs through eligible Participating Financial Institutions (PFIs) which are licensed and regulated financial institutions that are involved in lending to end borrowers; they include commercial banks, microfinance banks, merchant banks and mortgage banks. As at 31 December 2022, 40 PFIs had been onboarded, with funds disbursed to 27 PFIs comprising 16 microfinance banks, 7 commercial banks, 2 merchant banks and 2 primary mortgage banks. The Bank also provides partial credit guarantees for exposure to MSMEs (through its subsidiary) and technical assistance to improve the capacity of the target market through sponsored seminars, workshops and conferences. Technical support is also extended to PFIs to endear a better understanding and boost lending to MSMEs. Overall, in the last six years of operations, the Bank supported over 317,000 MSMEs with circa ₦640 billion loans and technical support.

Development Bank of Nigeria Plc operates from two locations, a head office located at The Clan Place, Plot 1386A Tigris Crescent, Maitama, Abuja and a liaison office located at Plot 952/953 Idejo Street, Victoria Island, Lagos.

Subsidiary

Impact Credit Guarantee Limited (ICGL) is the Development Bank of Nigeria Plc's only subsidiary. ICGL was established in 2019 and provides credit guarantees for loans granted by financial institutions to eligible businesses in the MSME segment. The Bank's investment in its subsidiary remained at ₦11.4 billion as at 31 December 2022. Within three years of operation, ICGL had guaranteed 27,208 loans (FYE 2021: 7,352 loans) amounting to ₦69.37 billion (FYE 2021: ₦62.5 billion) while ₦394 million (FY 2021: ₦7 million) was paid as claims for called guarantees in FY 2022. In FYE 2022, the subsidiary's pre-tax profit plummeted to ₦729.6 million in the year under review from ₦1 billion in the prior year.

Ownership and Support

DBN is owned by four key investors - the FGN (through the Ministry of Finance Incorporated (MOFI)), the Nigeria Sovereign Investment Authority (NSIA), the African Development Bank (AfDB) and the European Investment Bank (EIB). The AfDB is an '**Aaa**' rated development financial institution (by Fitch Ratings) that supports African governments and private companies with substantial investments in the regional member countries; AfDB supports DBN with long-term borrowings and governance in addition to its equity investment. The Nigeria Sovereign Investment Authority (NSIA), an **'Aaa'** rated investment institution (by Agusto & Co), was set up by an Act of the National Assembly to build a savings base for Nigeria, enhance the development of infrastructure in Nigeria and provide stabilisation support in a period of economic crisis. The European Investment Bank (EIB) is the lending arm of the European Union and one of the largest multilateral financial institutions providing climate finance; EIB is also rated **'Aaa'** by Fitch Ratings. The MOFI facilitated the sovereign guarantee used to support DBN's borrowings while also absorbing the associated currency risk. In the medium-term, Development Bank of Nigeria Plc seeks to expand its equity partners to other international development partners and financial institutions. The Bank has a founding charter which outlines strong governance standards and a clear mandate. DBN's shareholders strengthen the governance through representation on the Board of Directors and participation in the various Board committees. In mitigating political risk associated with development financial institutions with significant shareholding by government-related entities, the Directors are selected based on the Bank's stringent criteria and are subject to approvals by all shareholders.

Table 2: Shareholding Structure as at 31 December 2022

Shareholders	Shareholding (%)
FGN (represented by the Ministry of Finance Incorporated (MOFI))	59.87%
African Development Bank (AfDB)	17.98%
Nigeria Sovereign Investment Authority (NSIA)	14.97%
European Investment Bank (EIB)	7.19%
Total	**100%**

Board of Directors

As at 31 December 2022, an eleven-member Board of Directors comprising nine Non-Executive Directors (including six Independent Non-Executive Directors) and two Executive Directors govern the Development Bank of Nigeria Plc. According to the Bank's Corporate Governance policy, the Board members are appointed through a merit based, transparent process. Also, the shareholders and stakeholders of the Bank ensure adequate disclosure and transparency of the Board by setting up an 'effective governance department' that oversees the functions of the Board. Dr Shehu Yahaya chairs the Board which maintains four standing committees namely; the Board Nominations and Governance Committee, the Board Credit and Risk Committee (BCRC), the Board Audit and Compliance Committee and the Board Finance Committee. The responsibilities of the Board committees are defined by the Bank's charter, outlining its terms of reference and membership and authorised by the Board of Directors.

Current Directors		Institution Represented
Dr Shehu Yahaya	Chairman	*N/A*
Mrs Ijeoma D. Ozulumba	Executive Director	*N/A*
Mr Anthony Okpanachi	Managing Director/Chief Executive Officer	*N/A*
Mrs Clare Omatseye	Independent Non-Executive Director	*N/A*
Mallam Bello Maccido	Independent Non-Executive Director	*N/A*
Mr Andrew Alli	Independent Non-Executive Director	*N/A*
Mr Phillips Oduoza	Independent Non-Executive Director	*N/A*
Dr Oladimeji Alo	Independent Non-Executive Director	*N/A*
Mr Kyari Abba Bukar	Independent Non-Executive Director	*N/A*
Mr Henry Baldeh	Non-Executive Director	*African Development Bank*
Mr Omar Sefiani**	Alternate Director	*African Development Bank*

****Appointed on 1 August 2022**

Mr Uche Orji, a Non-Executive Director and representative of the NSIA, resigned from the Board of Directors on 30 September 2022 following the expiration of his tenure as the Managing Director of NSIA. The appointment of Mr Aminu Umaru, his successor as the Managing Director of NSIA as a Non-Executive Director of the Bank is currently undergoing regulatory approvals.

Mr Omar Sefiani was appointed as an Alternate Director to Mr Henry Baldeh during the year under review. Both Directors represent African Development Bank on the Board of DBN. Mr Omar Sefiani has over 15 years of professional experience in international markets. He is currently a Director of the Treasury Department at the AfDB with oversight on the Treasury Investments & Trading Division at the Bank. Prior to joining the AfDB in 2012, Mr Sefiani worked at Citigroup London as an Interest Quantitative Analyst. He also worked at Morgan Stanley London as a Hybrid Desk Strategist and at Credit Agricole as a Credit Structurer for Europe, Middle East and Africa (EMEA) clients. Mr Sefiani holds a degree in Applied Mathematics and Economics from the Ecole Polytechinique.

We consider DBN's governance structure to be good, upheld by the dominance of Independent Non-Executive Directors, the corporate governance policy and the founding charter.

Management and Staff

Development Bank of Nigeria Plc is overseen by a 14-member management team headed by Dr Anthony Okpanachi in his capacity as the Managing Director and Chief Executive Officer. Dr Okpanachi has over three decades of banking experience traversing management roles across various core functions including treasury management, retail business development, corporate finance, corporate services, branch and relationship management. Prior to his appointment at DBN, Dr Okpanachi served as the Deputy Managing Director of Ecobank Nigeria Limited, the Managing Director of Ecobank Kenya Limited, the Cluster Managing Director for Ecobank's East Africa operations (comprising Kenya, Uganda, Tanzania, Burundi, Rwanda, South Sudan and Ethiopia) and Managing Director of Ecobank Malawi Limited.

Dr Okpanachi holds a Bachelor of Science degree in Economics from Ahmadu Bello University, Zaria, a Master of Science degree in Economics from the University of Lagos, Akoka and a Master's in Business Administration (MBA) from Manchester Business School, UK. He also has a Doctor of Philosophy (PhD) degree in Economics from Nile University of Nigeria, Abuja. Dr Okpanachi is a Fellow of the Chartered Institute of Stockbrokers (CIS), the Chartered Institute of Bankers of Nigeria (CIBN) and the Institute of Credit Administration (ICA). He is also an associate member of the Nigeria Institute of Management (NIM) and a member of the Institute of Banking of Malawi.

Other members of the senior management team include:

Mrs Ijeoma D. Ozulumba	Executive Director and Chief Financial Officer
Mr Elvis Iyamu	Head, Risk Assessment
Mr Idris Salihu	Head Corporate Services
Mr Abubakar Usman Dunguza	Head, Treasury and Investments
Mr Augustine Uchechukwu Achikasim	Resident Control Officer
Mr Bonaventure Okhaimo	Chief Operating Officer
Mr Joshua O. Ohioma	Head, Internal Audit
Mr Olu Adegbola	Chief Risk and Compliance Officer
Mr Joseph Nnanna	Assistant Chief Economist
Mrs Marylene Uchenna Ogbonnaya	Head, Human Resource
Mr Olanrewaju Kunle Oginni	Business Development and Relationship Manager
Mr Shofola Osho	Company Secretary
Mr Abiodun Ijaware	Assistant Vice-President and Head, Information Technology

During FYE 2022, DBN employed an average number of 41 persons, lower than 46 persons in the prior year. The decline which was most prominent at the junior cadre level reflected the emigration of skilled workers from Nigeria on account of the ongoing war on talent. Nonetheless, personnel costs increased by 24.5% to ₦2.4 billion due to promotions and performance bonus-related accruals, training cost and salary review. Also, Staff productivity depicted by operating income per staff to average staff cost increased to 14.8 times (FYE 2021: 14.1 times), better than 6.6 times recorded by the Nigerian banking industry and other "**Aaa**" rated development financial institutions operating in Nigeria.

Overall, we consider DBN's staff productivity to be good for a wholesale development finance institution, supported by an experienced and stable management team.

ANALYSTS' COMMENTS

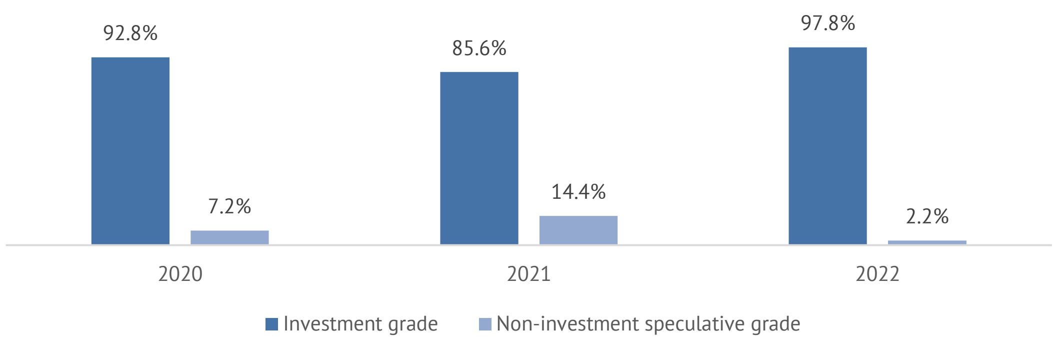
ASSET QUALITY

Development Bank of Nigeria Plc provides financial support (in form of loans) to micro, small and medium-sized enterprises in different sectors of the Nigerian economy through selected financial institutions named eligible financial institutions. The MSME's loans have a single obligor limit of ₦72 million and ₦200 million for short-term loans (maximum of 3 years tenor) and medium to long-term loans (3 to 10 years tenor) respectively. On the other hand, for small corporates, short term loans have an obligor limit of ₦288 million while medium to long-term loans have an obligor limit of ₦720 million.

The Bank intensified loan disbursement during the year under review and decided not to reinvest maturing treasury securities as part of the funding for new loans. The low yield on the treasury securities, relative to the prevailing market rate, also supported the decision. Overall, the loan book grew by 15.1% year-on-year to ₦372.2 billion notwithstanding the prevailing macroeconomic headwinds.

Given that the credit risk of the MSME loans reside with the PFIs, in addition to serving as the conduit for disbursing the loans, ability to serve the target market and financial strength are considered in determining eligible PFIs. The footprint in the MSME segment and potentials for additional impact are considered before on-boarding a PFI. The Bank's internal credit rating model which consists of a 22-level risk rating scale, ranging from AAA to D, guides the financial strength assessment of PFIs. DBN requires eligible PFI to have investment grade rating (BBB- and above) on its internal model. Existing PFIs with a rating downgrade to the non-investment grade category (below BBB-) are subjected to various penalties including suspension of further disbursement, reduction in the authorised limit, among others. During the year under review, all PFIs except one were adjudged investment grade obligors based on the Bank's internal assessment; hence, 97.8% of the PFIs fell within the Bank's own investment grade, while only 2.2% fell within the non-investment grade. We consider the internal rating model of DBN to be adequate. In addition to its internal credit rating model, DBN also carries out an annual independent due diligence exercise on the PFIs to assess their risk profile and moderate the probability of default.

Figure 1: Loan Portfolio by Credit Rating (FYE 2020 – FYE 2022)



During the year under review, DBN on-boarded seven additional PFIs. As at FYE 2022, the PFIs with funding from the bank increased PFIs to 27 from 20 in the prior year. Notwithstanding, the loan book remained concentrated in commercial banking PFIs as at FYE 2022. While we note positively the ongoing plans to on-board more microfinance banks given their strong affinity with the MSMEs, we believe the commercial banks will remain dominant given their relatively large size and ability to reach the target market.

Figure 2: Loan book by PFI types in FYE 2022

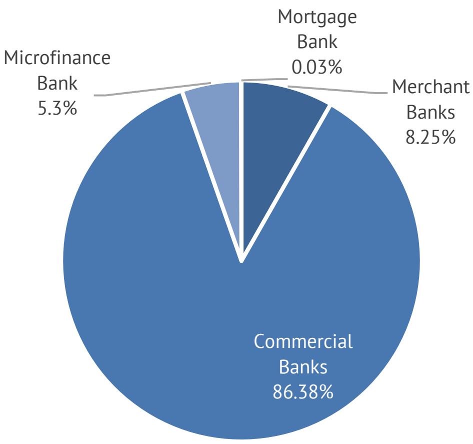
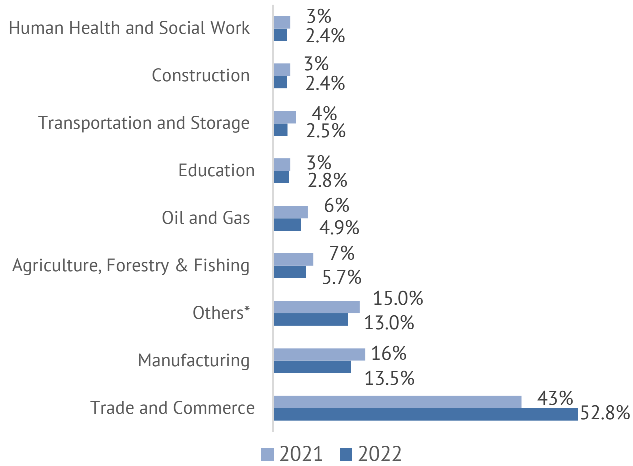


Figure 3: Breakdown of PFIs by Sector in FYE 2022



**Other sectors include Accommodation & Food service, Administrative and Support Services, professional scientific and technical services, real estate services, information technology, arts and recreation*

A review of the ultimate beneficiaries (MSMEs) reveals high concentration in the trade and commerce sector. Although this reflects the distribution of MSMEs in Nigeria, it makes the Bank highly vulnerable to shocks in the trade and commerce sector specifically persistent devaluation of the Naira and rising inflation. As at FYE 2022, the MSME-beneficiaries were located mainly in the South-West geopolitical zone of Nigeria by 53.8%, driven by high commercial activities in the region, precisely in Lagos, relative to the other regions such as the South South (15.2%), North Central (6.9%), North West (4.4%), Abuja (6.5%) and North East (0.8%). Notwithstanding similar concentration levels in prior year, the spread of loans across the geopolitical zones improved during the year.

As at 31 December 2022, DBN's credit exposures to the PFIs are fully collaterised. Exposures to commercial banks that are adjudged as "significantly important" are secured by direct debit mandate on their respective account with the CBN. Loans to other PFIs are secured by pledged treasury securities, lien on bank deposits, movable asset register, corporate guarantee, among others. Loans to microfinance banks and other PFIs adjudged to have medium to high credit risk are expected to have collateral coverage above the 100% mandated in the Bank's credit policy. We believe that the Bank's collateral system has helped to uphold asset quality.

As at FYE 2022, DBN had no impaired loans and the entire portfolio was classified in the stage 1 category which comprise loans with relatively low default risk. Since inception in 2017, the Bank's exposures are all adjudged to have relatively low default risk and thus classified as stage 1 loans. Notwithstanding, DBN makes annual provisions in line with the IFRS 9 accounting standard. As at FYE 2022, cumulative loan loss provision stood at ₦2.8 billion, representing 0.5% of gross loans and 20 basis point higher than the prior year.

As at FYE 2022, the Bank's investment portfolio comprised only placements with commercial banks following the decision not to discontinue investment in treasury securities. As at the same date, the investment portfolio stood at ₦130.7 billion. We note positively that as at 31 December 2022, the placements were invested in investment grade financial institutions.

Overall, we consider the Bank's asset quality to be good, upheld by the wholesale lending model and a conservative risk management framework. DBN intends to grow the loan portfolio by 7% to ₦416 billion by FYE 2023 which is feasible in our view. There are plans to further expand the PFIs to private equity firms, fintech, non-interest banks in the medium-term. We believe the risk profile of some of these financial institutions is higher than the Bank's threshold, particularly those that are not under the direct purview of the CBN.

RISK MANAGEMENT

Development Bank of Nigeria Plc maintains a moderate risk appetite while delivering on the mandate of providing credits to MSMEs through eligible PFIs. The Bank has an independent risk management function, headed by the Chief Risk Officer (CRO) who reports to the Board Credit and Risk Committee (BCRC), although with an administrative reporting line to the Managing Director. The CRO oversees the enterprise risk management unit, the risk management and rating unit as well as the compliance and internal control unit.

Credit Risk: The Bank adopts a standardised approach for its credit risk management under the Basel II accord. DBN also operates a rigorous underwriting process, with six stages before the disbursement of a loan and a continuous monitoring process. The Bank expects all participating financial institutions or intermediaries to meet some eligibility criteria including the following;

- A valid CBN licence to operate as a financial institution
- Two years of profitable activities within the three most recent financial years
- A qualified and experienced management
- Adequate organisation and institutional capacity
- Compliance with all CBN prudential guidelines on capital adequacy, liquidity and solvency

During FY 2022, DBN reviewed its pricing of loan and adopted a cost-plus and risk-based pricing model which takes into consideration the cost of funds, cost of operations and the level of risk associated with the respective PFI. Loans disbursed to on-boarded PFIs are constantly reviewed and approved by the BCRC, with inputs and recommendations from the CRO and Management Credit and Risk Committees, which help identify possible signs of impairment and prudential ratios.

Market and Liquidity Risk Management: DBN is exposed to volatilities in interest rates through its investments in financial instruments such as loans and fixed income securities. During the year under review, the Bank divested from treasury securities given that the associated yields remain low while the prevailing interest rate maintained an upward trajectory. Therefore, placements with financial institutions are easy to reprice given that the Bank stays at the short end of the investment curve.

As at FYE 2022, a 100 basis points increase in the prevailing interest rate would have elicited additional income of ₦1.4 billion, representing 4% of net income. Similarly, a 100 basis points decrease in the prevailing interest rate would have resulted in a decline in income by ₦1.4 billion, representing 4% of net income. Potential gaps in maturity profile of the Bank's assets and liabilities are constantly monitored by the risk management unit while exceptions are reported to the Bank's Asset and Liabilities Committee (ALCO). The ALCO also ensures effective management of the interest rate gaps, by establishing adequate buffers in managing such exposures.

DBN mitigates currency risk by ensuring that the Federal Government of Nigeria through the Federal Ministry of Finance acts as the counterparty to its borrowings from development partners which are denominated in foreign currencies. The Bank access the funds from the Federal Ministry of Finance and repay the obligations in naira. As a result, DBN has minimal exposure to currency risk.

Operational Risk: DBN adopts the Basic Indicator Approach (BIA) to measure operational risks emanating from people, processes, systems and external events. The Bank's operations policy is reviewed biennially to ensure relevance and effectiveness in view of the changing regulations, operating environment and evolving technology. The Enterprise Risk Unit, within the risk management division oversees the operational risk functions of the Bank. During the year under review, no penalty was paid for regulatory infraction, same as the prior year.

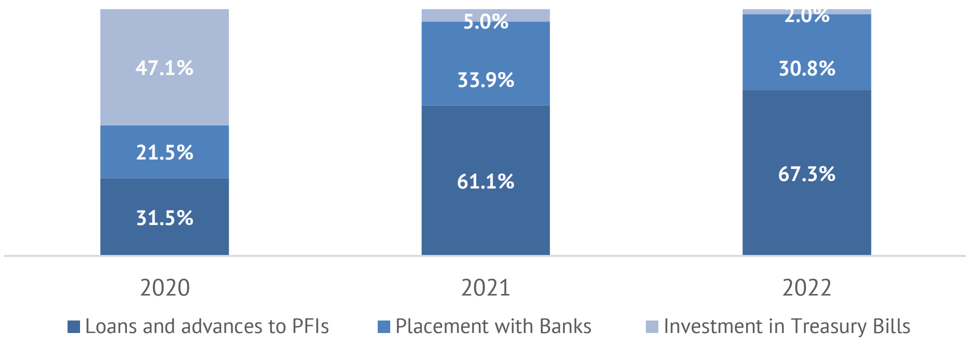
Overall, we consider DBN's risk management framework to be good for the level of risks undertaken.

EARNINGS

Development Bank of Nigeria Plc generates earnings primarily from interest income on loans extended to eligible PFIs (for on lending to MSMEs) and investment securities (bank placements and other fixed income securities). During the financial year ended 31 December 2022, DBN generated ₦47.5 billion billion as gross income, a 24.3% increase from the prior year. Fund-based income which grew by 24.6% year-on-year remained dominant and similarly accounted for 98.9% of gross income as the prior year, while non-fund-based income remained negligible despite the 25.2% growth during the year under review.

The Bank's interest income increased year-on-year by 25.6% to ₦47 billion in the financial year ended 31 December 2022, largely propelled by the 15.1% expansion in the loan book. Consequently, interest income from loans and advances increased by 37.2% to ₦31.6 billion and remained the largest source of income. Notwithstanding the 3.2% decline in bank placements, the rising yield environment drove a 13% increase in the associated interest income to remain a significant source of income. In the near term, we anticipate further increase in the interest income and the loan book is expected to remain the largest contributor on the back of the projected 7% loan growth. The rising yield environment will also support income from the investments.

Figure 4: Breakdown of Interest Income (FYE 2020 – FYE 2022)



During FY 2022, the Bank paid ₦11.2 billion as interest expense, a marginal 4% decline from with the prior year due to repayment of the borrowings from the international development partners. Overall, the net yield on the earning assets (loans and investment securities) improved to 7.4% from 5.6% in the prior year. We anticipate a further increase in the asset yield in the near term on the back of the cost-based pricing of the bank. However, the plan to crowding-in additional funding from international development partners coupled with the scheduled ₦20 billion bond issuance (in a period of rising interest rates) will increase the interest expense and moderate the average yield on earning assets in FY 2023.

In FY 2022, DBN recorded an impairment charge of ₦1.2 billion compared to a ₦351.3 million writeback posted in the prior year. Although all financial assets remained in the stage 1 (low risk) category, the downgrade of Nigeria's sovereign rating raised the probability of default and the resulting impairment charge. We expect higher impairment charge in the near term given the projected loan growth and on-boarding of microfinance banks with relatively higher risk profile (albeit with strong affinity with the MSMEs) and intensifying macroeconomic headwinds.

Grant income from international development partners for the provision of technical support to MSMEs and to a less extent revaluation gains on foreign exchange receivables drove a 25.2% increase in non-funded income to ₦543.3 million in FY 2022. Overall, DBN's operating income grew by 30.9% to ₦35.1 billion during the year under review, largely driven by the spike in interest income. We expect the operating income to maintain its growth trajectory in FY 2023 on the back of the planned loan book expansion. The planned upscale in technical support to MSMEs will also elicit more grant income in the near term, although the anticipated increase in interest expense will be a drag.

In the year under review, business expansion and inflationary pressure drove a 37.5% increase in operating expenses to ₦5.6 billion. As a result, the cost-to-income ratio (CIR) increased to 15.9% (FYE 2021: 15.1%). Given the further business expansion plans and the ravaging inflationary pressures, we expect the CIR to maintain its upward trajectory in FY 2023. Notwithstanding, we believe that the pricing model and earning asset growth will keep the CIR below the 20% threshold.

DBN's profitability remains stable but moderate, reflecting its developmental mandate. In FYE 2022, the Bank's pre-tax profits grew by 29.7% to ₦29.5 billion. Profitability ratios also improved as the pre-tax return on average assets (ROA) and pre-tax return on equity (ROE) increased to 5.8% (FYE 2021: 4.6%) and 14.6% (FYE 2021: 12.3%) respectively. The ROA compares better than 2% recorded by the Nigerian banking industry. However, the banking industry posted a better ROE (23.7%) given its higher leverage position. Nonetheless, the Bank's profitability ratios are similar to other **"Aaa"** rated development finance institutions operating in Nigeria that similarly balance their developmental roles with profitability, given their average ROE and ROA of 2.5% and 10.1% respectively. We consider the Bank's profitability ratios to be acceptable given that developmental impact and sustainability are its focus and not necessarily making profit. In the near term, we expect higher profitability indicators based on the scheduled growth plans although the raging headwinds, rising interest rate environment and inflationary pressure will moderate performance.

CAPITAL ADEQUACY

Since its inception in 2017, the Bank has grown its capital base predominantly through retained earnings. During the year under review, the Bank made its first dividend payment in its history of operation since its inception. However, despite being in its sixth year of operation, the Bank does not have a dividend policy. Notwithstanding, earnings retention drove the increase in the shareholders' funds during the period. As at 31 December 2022, DBN's shareholders' funds stood at ₦212.2 billion reflecting a 10.1% year-on-year increase. At this level, the shareholders' funds were more than twice the ₦100 billion regulatory minimum for wholesale development finance institutions operating in Nigeria. As at FYE 2022, the Bank's shareholders' funds represented 51.5% (FYE 2021: 52.4%) of the risk weighted assets, significantly higher than our 6% threshold. Although the outstanding long-term borrowings from international development partners amounting to ₦291.1 billion potentially qualify as tier 2 capital, the regulatory guidelines limit the tier 2 capital used in the computation of the capital adequacy ratio was capped at 33.3% of tier I capital.

As at FYE 2022, DBN's capital adequacy ratio (CAR), computed in line with Basel II accords, was strong at 64.3% and is above the regulatory minimum of 10% for wholesale developmental banks. We consider the capitalisation of the Development Bank of Nigeria Plc to be strong for current business risks. The profile of the shareholders and their willingness to support the Bank when needed is noted in the rating assessment. Thus, we do not anticipate a significant deterioration in the capitalisation in the near to medium term.

LIQUIDITY AND FUNDING

Development Bank of Nigeria Plc is funded by shareholders' funds and borrowings from international development partners including the World Bank, French Development Agency, KfW German Development Bank and the AfDB. The borrowings which are backed by a sovereign guarantee and denominated in foreign currency are disbursed directly to the Federal Ministry of Finance. Subsequently, the funds are converted to naira and disbursed to the Bank after meeting all conditions. DBN repay the naira obligation to the Federal Ministry of Finance; thus, mitigating the currency risk associated with the borrowing.

As at 31 December 2022, DBN's total borrowings stood at ₦291.1 billion, representing a marginal 2.4% decline with the gradual repayment of the obligations. As a result, total borrowings funded a lower 56.3% (FYE 2021: 59.7%) of the asset base as at FYE 2022. As at the same date, the Bank did not breach any of the terms and covenants of its borrowings. In the near term, DBN plans to diversify its funding by accessing the capital market with a debut ₦20 billion fund and is currently in the process of seeking green financing for climate protection projects from the KfW German Development Agency. The Green Climate Funds, which would be sourced from various international development partners, will be used to fund environmentally friendly projects. The ₦20 billion bond is expected to be issued in Q2 2023.

Table 3: Schedule of the Bank's Borrowings as at FYE 2022

Development Partner	Interest Rate	Tenor	Outstanding Balance as at FYE 2022
International Bank for Reconstruction and Development (IBRD) US$480 million commitment	4%	21 years	₦147.9 billion
French Development Agency (AFD) US$130 million commitment	3.55%	10 years	₦33.6 billion
KfW German Development Bank US$200 million commitment	3.99%	10 years	₦40.7 billon
African Development Bank (AfDB) US$400 million commitment	4%	15 years	₦56.3 billion
Fund of the AfDB	1%	15 years	₦12.7billion

During the year under review, gradual repayment of some borrowings elicited a 10 basis points decline in the weighted average cost of funds (WACF) to 3.81%. The fixed rate structure of the borrowings curtailed the increase in funding costs despite the rise in the global interest rate. In the near term we anticipate an increase in the WACF on the back of the double-digit coupon rate expected on the ₦20 billion bond. However, the 2% interest rate projected on a new borrowing from an international development partner will moderate the impact.

DBN's liquid assets represented 45% (FYE 2021: 54%) of total borrowings as at FYE 2022, significantly higher than the 10% regulatory threshold. As at the same date, the Bank's liquid assets to near term obligations (loans yet to be disbursed, planned capital injection into the subsidiary and borrowing repayment over the next 1 year) stood at 73.1%; which we consider good.

In our opinion, the liquidity profile of the Development Bank of Nigeria Plc is good and the funding strategy is effective. We also view positively, the impact of the high-quality international development partners, who have upheld stability in the funding base since its inception.

ENVIRONMENT, SOCIAL AND GOVERNANCE

In our view, DBN has maintained a robust governance structure since its inception, supported by its shareholders that strengthens its governance, which is also backed by the regulatory requirements of the SEC and the CBN. Nonetheless, we believe that the gender diversity of the Bank's Board requires improvement as the female directors constituted a meagre 18% of the Bank's Board of Directors as at 31 December 2022, which is lower than CBN's 30% regulatory threshold.

While the Bank's exposure to businesses with a high footprint on the physical environment is low, the Bank's impact on ESG profile is prioritised, considering that it is a development finance institution. As part of its efforts towards ensuring environmental and social sustainability, the Bank held for its PFIs, a 2-day Environmental and Social (E&S) Capacity Building program during the FYE 2022, which was delivered by expert environmental and social standards consultants in Natural Eco Capital; it focused on Business Case for Sustainability and the possible impacts of ESG violations for financial institutions. In the near term, the Bank plans to crystalise interventions in forms of Green Finance from the French Development Agency, KfW German Development Bank, the EIB and the World Bank, which are expected to be channelled towards enhancing green climate in Nigeria; the Green Finance is expected to aid DBN's impact across country (geography) and demography, ensuring that all unserved and underserved markets are addressed, while focusing on environmental sustainability. For instance, the Bank plans to collaborate on green finance schemes with PFIs by promoting programs such as 'Interest Drawback Program (IDB)' which would serve as an incentive for PFIs that finance green businesses.

The Bank has also continued to propel micro-enterprises and female-led beneficiaries through its MSME funding; as at 31 December 2022, female-led MSMEs constituted 67% of the Bank's beneficiaries while males were 33%. Also, 33% of the MSME owners fell into the micro enterprises class and had the largest share relative to other classes such as the small corporates (25%), small enterprises (24%) and Medium sized enterprises (18%).

OUTLOOK

Over the next five years, the Bank plans to expand its beneficiaries by up to 634,000, while onboarding more eligible PFIs including newly licensed banks, FinTechs and venture capital firms, thereby supporting loan growth. In addition, DBN plans to commence green financing having received accreditation from the Green Climate Fund, which will focus on green funding to PFIs, enhanced risk management drive, vital affiliations & accreditations with green partners, and capacity building on the use of green finance for MSMEs. To diversify its funding sources, the Bank is accessing the Nigerian capital market with a registered ₦100 billion debt issuance programme, out of which ₦20 billion bond is expected to be issued by Q2 2023.

Agusto & Co. expects DBN's capitalisation to remain strong in the near to medium term underpinned by the support of its existing shareholders. We also believe that the Bank's wholesale lending model as well as the collateral system will maintain asset quality. The Bank's strong relationship with international development partners as well as the strong support from the Ministry of Finance Incorporated, that provides a sovereign guarantee for the Bank's foreign currency borrowings and hedges the associated currency risk, should continue to support DBN's funding base. We expect the Bank's financial strength to continue to be strong and therefore we attach a **stable** outlook to the rating of Development Bank of Nigeria Plc.

FINANCIAL SUMMARY

Development Bank of Nigeria Plc

STATEMENT OF FINANCIAL POSITION	31-Dec-20		31-Dec-21		31-Dec-22	
	N'000		N'000		N'000	
ASSETS						
Cash & Equivalents	258,130	0%	222,118	0%	319,853	0%
Government Securities	14,162,048	5%	26,618,294	3%	-	48%
Quoted Equity Investments (Net)	-		-		-	
CASH & MARKETABLE SECURITIES	**14,420,178**	**5%**	**26,840,412**	**3%**	**319,853**	**48%**
Due from Financial Institutions	249,017,146	27%	135,098,925	51%	130,738,904	27%
Loans to Customers	215,129,830	65%	323,254,445	44%	372,185,667	22%
Others	-		-		-	
Gross Loans	**464,146,976**	**92%**	**458,353,370**	**94%**	**502,924,571**	**49%**
Less: Cumulative loan loss provision	(1,106,658)	0%	(1,559,570)	0%	(2,783,099)	0%
TOTAL LOANS & ADVANCES - NET	**463,040,318**	**91%**	**456,793,800**	**94%**	**500,141,472**	**49%**
Unquoted Equity Investments(Net)	-		-		-	
Trading Securities	-		-		-	
OTHER EARNING ASSETS	**-**		**-**		**-**	
TOTAL OTHER ASSETS	1,386,334	0%	1,791,061	0%	2,764,409	0%
TOTAL OTHER LONG-TERM ASSETS	11,375,000	2%	11,375,000	2%	11,375,000	2%
TOTAL FIXED ASSETS & INTANGIBLES	2,090,403	0%	2,441,940	0%	2,635,668	0%
TOTAL ASSETS	**492,312,233**	**100%**	**499,242,213**	**100%**	**517,236,402**	**100%**
TOTAL COMMITMENTS	-		-		-	
TOTAL ASSETS & COMMITEMENTS	**492,312,233**	100%	**499,242,213**	100%	**517,236,402**	100%
CAPITAL & LIABILITIES						
TIER 1 CAPITAL (CORE CAPITAL)	**176,926,983**	**39%**	**192,645,291**	**36%**	**212,179,206**	**34%**
SHORT TERM BORROWINGS					**-**	
LONG TERM BORROWINGS	**313,724,945**	60%	**298,134,621**	64%	**291,139,709**	65%
TOTAL INTEREST BEARING LIABILITIES	**313,724,945**	**60%**	**298,134,621**	**64%**	**291,139,709**	**65%**
TIER 2 CAPITAL	**313,724,945**	**60%**	**298,134,621**	**64%**	**291,139,709**	**65%**
TOTAL OTHER LIABILITIES	1,660,305	2%	8,462,301	0%	13,917,487	1%
TOTAL CAPITAL & LIABILITIES	**492,312,233**	100%	**499,242,213**	100%	**517,236,402**	100%
TOTAL COMMITMENTS						
TOTAL CAPITAL, LIABILITIES & COMMITMENTS	**492,312,233**	100%	**499,242,213**	100%	**517,236,402**	100%

Development Bank of Nigeria Plc

INCOME STATEMENT FOR THE YEAR ENDED	**31-Dec-20**		**31-Dec-21**		**31-Dec-22**
	N'000		**N'000**		**N'000**
Interest income	33,429,735	99%	37,726,675	100%	46,999,580
Interest expense	-11,270,015	-31%	(11,688,620)	-34%	(11,215,724)
NET INTEREST REVENUE	**22,159,720**	**68%**	**26,038,055**	**66%**	**35,783,856**
INCOME FROM EQUITY INVESTMENTS					
FEES & OTHER INCOME	59,461	1%	433,864	0%	543,295
Loan loss expense	(829,726)	1%	351,334	-2%	(1,217,699)
Equity impairment Charges					
OPERATING INCOME	**21,389,455**	**70%**	**26,823,253**	**64%**	**35,109,452**
STAFF COSTS	(1,240,514)	-5%	(1,906,848)	-4%	(2,373,758)
DEPRECIATION EXPENSE	(438,275)	-1%	(410,903)	-1%	(391,933)
OTHER OPERATING EXPENSES	(1,419,793)	-5%	(1,745,689)	-4%	(2,821,175)
OPERATING EXPENSES	**(3,098,582)**	**-11%**	**(4,063,440)**	**-9%**	**(5,586,866)**
NET INCOME	**18,290,873**	**60%**	**22,759,813**	**55%**	**29,522,586**
NON-OPERATING INCOME (EXPENSE) - NET					
ADDITIONAL INFORMATION					
Type of institution	**DFI**		**DFI**		**DFI**
Age (in years)	4		5		6
Number of offices	2		2		2
Average staff per office	28		23		21

Development Bank of Nigeria Plc

KEY RATIOS	31-Dec-20	31-Dec-21	31-Dec-22
PROFITABILITY RATIOS			
Return on earning assets (average)	5%	6%	7%
Return on average assets	4%	5%	6%
Return on average equity	11%	12%	15%
Loan loss expense/Interest income	2%		3%
Operating expenses/Net earnings	14%	15%	16%
Gross earnings/Total assets & contingents (average)	7%	8%	9%
Income from Equity Investments/Equity Investments			
LIQUIDITY RATIOS			
Total Debt/Liquid assets	119%	184%	222%
Liquid assets/Long term debts	84%	54%	45%
Liquid assets/Short term debts	100%	100%	100%
Liquid assets/Total assets	54%	32%	25%
ASSET QUALITY RATIOS			
PERFORMING LOANS	215,129,830	323,254,445	372,185,667
NON-PERFORMING LOANS			
Non-performing loans/Total loans - Gross			
Loan loss provision/Total loans - Gross	4%	-1%	3%
Loan loss provision/Non-performing loans			
Equity loss provision/Equity investments			
CAPITAL ADEQUACY			
Tier 1	175,928,266	191,772,534	210,805,086
Tier 2	175,928,266	191,772,534	210,805,086
Equity Cushion	36%	39%	41%
Risk Weighted Assets	352,384,765	403,979,582	450,172,977
Adjusted Capital	351,856,532	383,545,068	421,610,172
Basel 1			
Tier 1/ Total Capital	50%	50%	50%
Net Loans to adjusted capital	1.32	1.19	1.19
Tier 1/Risk Weighted Assets	50%	47%	47%
STAFF INFORMATION			
Average number of employees	56	46	41
Staff cost per employee (N'000)	22,152	41,453	57,897
Operating Income per staff (N'000)	381,955	583,114	856,328
Staff cost/Operating income	5.8%	7.1%	6.8%
Staff costs/Operating expenses	40.0%	46.9%	42.5%

RATING DEFINITIONS

Aaa	A development finance institution of impeccable financial condition and overwhelming capacity to meet obligations as and when they fall due.
Aa	A development finance institution of very good financial condition and strong capacity to meet its obligations as and when they fall due.
A	A development finance institution of good financial condition and strong capacity to meet its obligations.
Bbb	A development finance institution of satisfactory financial condition with adequate capacity to meet obligations as and when they fall due.
Bb	Financial condition is satisfactory and ability to meet obligations as and when they fall due exists.
B	Financial condition is weak but obligations are still being met as and when they fall due.
C	Financial condition is very weak. Net worth is likely to be negative and obligations may already be in default.
D	In default.

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.

ESG CREDIT RATING CONTRIBUTION SCORE GUIDE

1	Environmental, Social and Governance issues do not contribute to credit risk
2	Environmental, Social and Governance issues have minimal contribution to credit risk
3	Environmental, Social and Governance issues have a material contribution to credit risk
4	Environmental, Social and Governance issues contribute significantly to credit risk
5	Environmental, Social and Governance issues are major contributors to credit risk

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