NOVA Merchant Bank Limited

2021 Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Nova Merchant Bank Limited

Rating Assigned:
Bbb

A financial institution with satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due.

Outlook: Stable
Issue Date: 10 June 2021
Expiry Date: 30 June 2022
Previous Rating: Bbb

Industry: Merchant Banking

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Rating Rationale

Agusto & Co. hereby affirms the "**Bbb**" rating of Nova Merchant Bank Limited ('Nova MBL' or 'the Bank'). Nova MBL's rating is upheld by its good capitalisation, good asset quality and good profitability. The rating is however constrained by the obligor and sectorial concentration in the loan book, a concentrated deposit base which is tilted largely to more expensive funding sources (typical of merchant banks in Nigeria), slow economic recovery from the pandemic and changing regulations in the Nigerian banking industry.

Nova Merchant Bank Limited is a growing merchant bank with gross loans increasing year-on-year by 71% to ₦50 billion as at 31 December 2020, despite the negative effects of the COVID-19 pandemic on the banking industry. However, concentration in the loan book persists with two sectors accounting for 52.1% of gross loans as at the FYE 2020. As at the same date, the top five obligors represented 71% (FYE 2019: 72%) of gross loans. Although none of these exposures breached the regulatory threshold of 50% of shareholder's funds, the Bank remains vulnerable to an adverse performance by any of these key obligors. As at 31 December 2020, all of Nova MBL's loans were classified as stage 1 credits. However, ex-staff loans amounting to ₦46.3 million and representing a minute 0.1% of gross loans were classified as non-performing, based on prudential guidelines. While we consider the Bank's asset quality to be good, the lingering pandemic and the fragile state of the Nigerian macroeconomic environment brings to fore the need for proactive loan monitoring.

As at 31 December 2020, Nova MBL's shareholders' fund stood at ₦33.1 billion, significantly higher than the regulatory minimum of ₦15 billion for merchant banks operating in Nigeria. As at the same date, the Bank's adjusted capital, computed in line with Basel II precepts, funded 39.5% of its risk weighted assets, above the 10% minimum threshold set by the Central Bank of Nigeria. We consider Nova MBL's capitalisation to be good.

The Bank maintained a good liquidity profile with liquid assets to local currency deposits ratio of 69% (FYE 2019: 62%) as at the FYE 2020, higher than the regulatory liquidity ratio minimum of 20%. Nova MBL's liquidity profile continues to be sustained by its sizeable portfolio of liquid government securities. However, the haphazard cash reserve requirement deductions continues to be a threat to its liquidity position. The Bank's ability to refinance in the domestic market is also acceptable, recently tested by the issuance of its maiden ₦10 billion 7-year bond in 2020 which was oversubscribed by 300% during the year under review.

In the FY 2020, Nova MBL's interest income as disclosed in its audited accounts rose significantly by 112.1% year-on-year to ₦9.6 billion. In particular, during the year under review, interest income from the loan portfolio doubled to ₦4.2 billion and solely contributed 43.8% (FY 2019: 46.7%) to total interest income. Similarly, interest income on placements and fixed income securities rose by 420% and 49% respectively year-on-year reflecting the Bank's expansion in the FY 2020. During the same period, Nova MBL's operating expenses (OPEX) grew by 37.3% to ₦2.6 billion, highlighting the profile of a financial institution in its growth phase. Notwithstanding, the Bank's cost-to-income ratio (CIR) improved to 43% from 55.3% in the prior year on the back of improved earnings.

During the review period, profitability metrics, pre-tax Return on Average Asset (ROA) dipped marginally to 2% (FY 2019: 2.4%) as the asset growth was more significant relative to the increase in profit before tax. Nonetheless, the Bank recorded a higher pre-tax return on average equity of 16.3%, double the prior year's 8.2%. Nova MBL's ROE was also higher than the 13.2% average inflation rate recorded in the year under review. We consider the Bank's profitability to be good, especially in COVID-19 ravaged year.

Based on the foregoing, Agusto & Co. has attached a **stable** outlook to the rating of Nova Merchant Bank Limited.

Strengths

- Good capitalisation
- Good liquidity profile
- Improving profitability

Weaknesses

- High staff turnover at all levels especially senior management
- Limited track record
- Dominance of relatively costly term deposits in the funding structure, albeit typical in the merchant banks in Nigeria
- Obligor and sectorial concentration in the loan book

Challenges

- Maintaining a nil impaired credit position despite deteriorating macroeconomic environment
- Remaining profitable amidst heightened competition
- Sourcing long term stable funds

Table 1: Financial Data

	31 December 2019	31 December 2020
Total Assets & Contingents	₦96.9 billion	₦247.2 billion
Total Local Currency Deposits	₦40.2 billion	₦87 billion
Return on Assets & Contingents (ROA)	2.4%	2.0%
Return on Equity (ROE)	8.2%	16.3%

PROFILE

Nova Merchant Bank Limited ("Nova MBL" or "the Bank") was incorporated in May 2017 and obtained a merchant banking license from the Central Bank of Nigeria (CBN) in December 2017. The principal activities of the Bank include the provision of corporate banking and money market services (such as securities trading and holding marketable securities such as treasury bills and government bonds) to corporates and high net worth individuals.

The Bank's business is supported by 10 departments including Risk Management and Compliance, Strategy, Information and Technology, Operations, Internal Control, Finance, Compliance, Corporate Services, Human Capital Management and Communication, Marketing & Branding. Nova MBL operates from 23 Kofo Abayomi Street, Victoria Island, Lagos.

Subsidiaries

Nova Merchant Bank Limited has two subsidiaries; NovaMBL Asset Management Limited and NovaMBL Securities Limited. As at 31 December 2020, the Bank's investment in these subsidiaries stood at ₦415 million.

Table 2: Subsidiaries of Nova Merchant Bank Limited

Name	Principal Activities	Ownership Stake
NovaMBL Asset Management Limited	Asset Management	99%
NovaMBL Securities Limited	Broker and Dealer	88.3%

NovaMBL Asset Management Limited provides funds and portfolio management services to individuals, corporates and institutions. As at the FYE 2020, NovaMBL Asset Management Limited had a total asset base of ₦467.3 million while the assets under management (AuM) stood at ₦10.5 billion.

NovaMBL Securities Limited provides securities trading service. The subsidiary which commenced operations during the year under review has a total asset base of ₦438.6 million as at the FYE 2020.

Information, Communication & Technology (ICT)

Nova Merchant Bank Limited deploys a range of software applications and hardware appliances for its day-to-day core banking and investment businesses. During the review year, a secured virtual private network was acquired and access granted to staff to enable efficient remote working following the outbreak of the COVID-19 pandemic in Nigeria.

Nova MBL uses the full Intellect Digital Core banking application provided by the India-based banking technology developer, Intellect Design Arena. The Bank's core banking application contains trade, treasury, lending, anti-money laundering, internet and mobile banking modules. In 2021, the Bank aims to improve its IT Infrastructure and implement a workflow document management system via SharePoint. There are also near term plans to boost mobile banking by enabling payments to third parties. The Bank has two remote data centres for its IT infrastructure. The primary data centre is located in Ikeja, Lagos and a secondary data centre in Lekki, Lagos to reduce disruptions in service delivery.

Correspondent Banks

During the 2020 financial year, Nova Merchant Bank Limited maintained a local banking relationship with United Bank for Africa (UBA) Plc and foreign banking relationship with UBA New York. There are plans to establish more correspondent banking relationships to support the projected business growth.

Track Record of Performance

Nova Merchant Bank Limited's total assets and contingents grew by 155% year-on-year to ₦247.2 billion as at 31 December 2020. The Bank's gross loans and advances also grew markedly by 71% year-on-year to ₦50.1 billion with all credit facilities categorised as stage 1 exposure as at FYE 2020. As at the same date, Nova MBL's shareholders' funds (₦33.1 billion) and capital adequacy ratio (39.5%) stood higher than the ₦15 billion and 10% regulatory minimum for merchant banks operating in Nigeria.

Nova MBL's profitability strengthened with a 125.8% growth in pre-tax profit to ₦3.4 billion in FY 2020 as disclosed in the financial statements audited by Pricewaterhouse Coopers (PwC). This translated to a pre-tax return on average assets (ROA) and a pre-tax return average equity (ROE) of 2% (FY 2019: 2.4%) and 16.2% (FY 2019: 8.2%) respectively.

Current Directors	Position/Designation	Shareholding (%)
Phillips Oduoza	*Chairman*	*50.493%**
Nath Ude**	*Chief Executive Officer/Managing Director*	*Nil*
Funke Okoya***	*Executive Director*	*Nil*
Shams Butt	*Non-Executive Director*	*Nil*
Chief Malachy Nwaiwu	*Independent Director*	*Nil*
Emmanuel Ijewere	*Independent Director*	*Nil*
Bolanle Onagoruwa	*Independent Director*	*Nil*
Habiba Ammah Wakil	*Independent Director*	*Nil*

**Direct and indirect shareholdings **Appointed October 2020 ***Appointed November 2020*

Management Team

Mr Nath Ude is the Managing Director and Chief Executive Officer of Nova Merchant Bank Limited. He replaces Mr Anya Duroha who was appointed in January 2019 and resigned in October 2020. Mr Ude served as the Deputy Managing Director of the Bank from July to September 2020, before he was appointed as the Managing Director. Mr Ude has circa three decades of experience in the banking industry, commencing from Citibank Nigeria Limited. He has held several senior banking positions including Executive Director, First City Monument Bank Limited (FCMB) and Executive Director, Union Bank of Nigeria Plc. He was a Non-Executive Director of the Nigeria Inter-Bank Settlement System Plc (NIBSS) and an Honorary Senior Member of the Chartered Institute of Bankers of Nigeria (CIBN). Mr Ude has a B.Sc. in Finance from the University of Nigeria, Nsukka and two Masters in Business Administration from Bayero University, Kano and the University of Bangor, Wales.

Other members of Nova Merchant Bank's management team are:

Funke Okoya	*Executive Director, Business Development*
Chinedu Ekeocha	*Chief Operating Officer*
Ifeatu Onwuasoanya	*Chief Audit Executive*
Akinwale Olawoye	*Chief Compliance Officer*
Kubi Momoh	*Chief Risk Officer*

Analysts' Comments

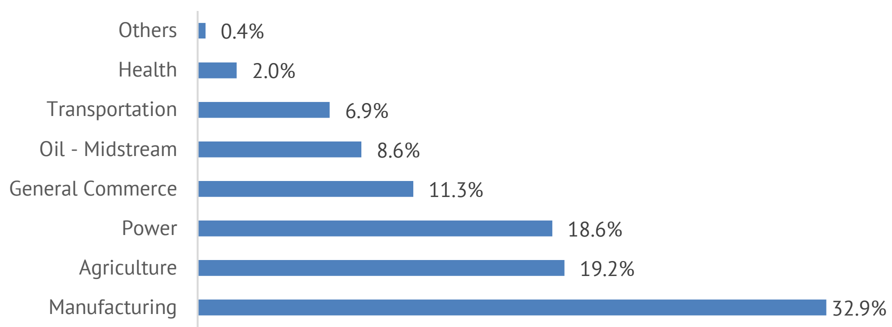
Asset Quality

As at 31 December 2020, Nova Merchant Bank Limited's total assets and contingents stood at ₦247.2 billion, a significant 155% growth from the prior year, despite the negative effects of the COVID-19 pandemic on the banking industry during the year under review. Liquid assets (mainly treasury securities) of ₦76.9 billion (a 233% year-on-year growth) accounted for the largest component (31%) of total assets and contingents as at the FYE 2020. The loan portfolio was the second-largest asset class and accounted for 20% of the asset base as at the same date. Restricted funds which grew 26.3 times year-on-year to ₦35.6 billion constituted 14.2% of total assets and contingents as at FYE 2020. The growth was due to the revision of the cash reserve ratio for merchant banks to 27.5% from 2% in January 2020 together with CBN's arbitrary deductions. These sterile funds, which are not available for daily banking operations, represented 155% of shareholders' funds and constrained the Bank's performance in the review period.

Nova MBL's lending strategy is focused on providing innovative short term loan solutions to clients – particularly operators in the fast-moving consumer goods (FMCG), oil and gas, general commerce, telecommunications and agriculture sectors. However, the Bank is fast tilting towards providing longer-tenured credit facilities as part of its mission to provide solutions to businesses and in line with the CBN's guidelines for real sector support. As at 31 December 2020, Nova MBL's gross loans and advances stood at ₦50.1 billion, 71% higher than ₦29.3 billion recorded as at the FYE 2019. While the loan growth seems high in a COVID-19 distraught year and higher than the 37.5% average loan growth recorded by the merchant banks during the year under review, we note that such growth is typical of a bank in its early years of operations. We also note positively the quality of the collaterals provided by Nova MBL's obligors. As at FYE 2020, all credit exposures were fully covered by collaterals – largely cash and cross-company guarantees.

During the year under review, loans to the manufacturing sector spiked by 349% to ₦16.5 billion and represented 33% of gross loans and advances. The Bank had extended additional finance solutions to manufacturing companies with working capital needs following the naira devaluation given their significant dependence on imported inputs.

Figure 1: Loan Book by Sector as at FYE 2020



Loans to agriculture operators also accounted for 19.2% of total loans, growing by 19% to ₦9.6 billion in the review period. These agriculture operators are largely agro-food processors with backward integrations who enjoyed higher demand due to the COVID-19 induced prolonged lockdowns. Loans to traders (classified under general commerce) grew by 103% to ₦5.7 billion as at the FYE 2020, buoyed by the reopening of the economy after the COVID-19 prolonged lockdown. We are concerned that the dwindling customer purchasing power, on the back of the prevailing macroeconomic headwinds which has also lengthened the trade cycles, could adversely impact the performance of these obligors.

As at the FYE 2020 and buoyed by a successful bond issuance, Nova MBL was able to disburse loans of ₦9.3 billion to the power sector and ₦4.3 billion to the oil and gas midstream sector. The power sector exposure was an upstream gas project and the Bank was in a consortium of other financial institutions. Nova MBL's oil and gas midstream exposure was to support the acquisition of infrastructure for refined petroleum products.

In 2021, Nova MBL projects a 155% growth in the loan book with a primary focus on resilient businesses in the manufacturing, FMCG, logistics and oil and gas downstream sectors. The loan growth is overly optimistic in our view given Nigeria's slow economic recovery and the intense competition in the corporate lending space. To emphasise Nigeria's challenging business environment, the loan book had declined by 4% to ₦47.9 billion as at 31 March 2021. As the Bank expands the loan portfolio in 2021, we anticipate further diversification of the loan book. However, we expect the manufacturing sector to remain the largest contributor in the short term.

Nova MBL's loan book is concentrated by obligor as the top five borrowers accounting for 71% (FYE 2019: 72%) of gross loans as at FYE 2020. As at FYE 2020, the largest exposure accounted for 42% of shareholders' funds, slightly lower than the 50% regulatory threshold. We believe that the Bank remains vulnerable to a deterioration in the financial condition of these key obligors. Moreover, given that 22% of the loan portfolio was denominated in foreign currency, further naira devaluation could result in a breach of the single obligor limit.

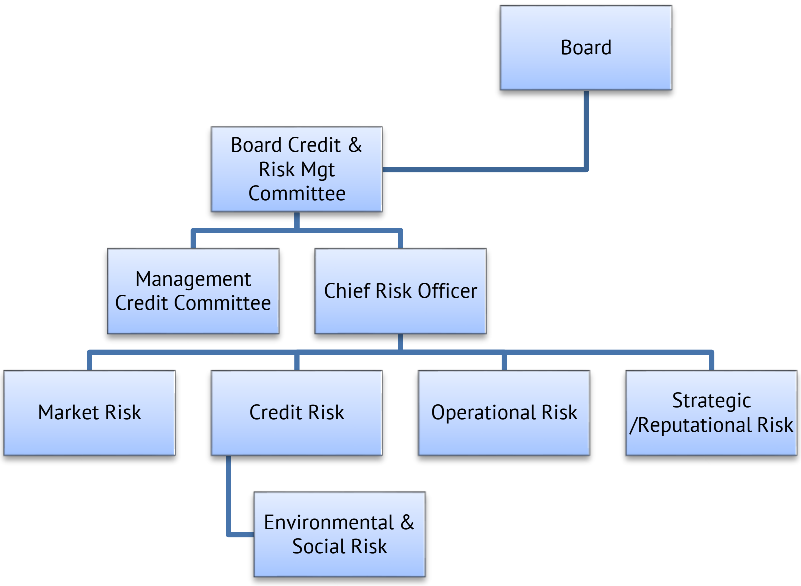
As at the FYE 2020, all of the Bank's credit facilities were classified as stage 1 exposures based on IFRS 9 tenets. However, ex-staff loans of ₦46.3 million have been classified as lost loans according to CBN's prudential guidelines. Nonetheless, these non-performing staff loans accounted for a negligible 0.1% of gross loans. Nova MBL's select peers; Coronation Merchant Bank Limited (Coronation MBL) and Rand Merchant Bank Limited (Rand MBL) also recorded nil impaired credit positions as at the FYE 2020. While we attribute the Bank's insignificant impaired credit position to the strength of its risk management framework thus far, we believe the resilience of Nova MBL's underwriting standards is yet to be fully tested, given the young age of the institution. As part of the measures to moderate incurred loss in the event of a default, the Bank requires obligors to provide collateral for all credit exposures and contingent liabilities. As at the FYE 2020, the collaterals provided were valued at ₦52.3 billion and covered the Bank's total loan exposures 1.04 times. Cash deposits accounted for 49% of total collateral while all asset debenture, corporate guarantee and other relatively low liquid collaterals accounted for the balance of 51%.

We consider Nova MBL's asset quality to be good. However, given the lingering pandemic and the fragile state of the Nigerian macroeconomic environment, we believe increased loan monitoring is required, particularly for obligors operating in the manufacturing, agriculture and power sectors.

RISK MANAGEMENT

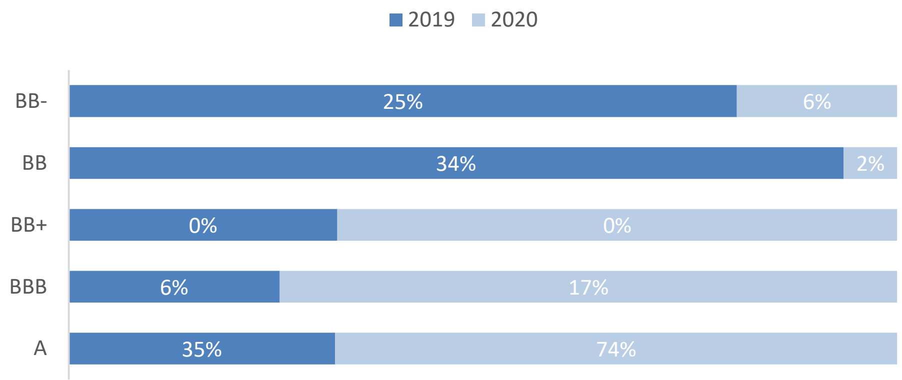
Nova Merchant Bank Limited's risk management is governed by the Board of Directors that approves the risk strategies and policies. The Bank has four Board Standing Committees namely; the Board Audit Committee, the Board Finance and General-Purpose Committee, the Board Nomination and Governance Committee, and the Board Credit and Risk Management Committee each of which is chaired by a Non-Executive Director. While the Board provides oversight of risk management at Nova MBL, the Chief Risk Officer (CRO) is primarily responsible for the implementation of the enterprise risk management framework.

Figure 2: Nova MBL's Risk Management Organogram



Credit Risk: Nova MBL is exposed to credit risk through its lending activities and investments in financial assets. A Board-approved credit policy guides the lending activities of the Bank. All credit facilities are approved by the Board of Directors (via its Credit & Risk Management Committee) after discussions at the Management Credit Committee. The risk management and compliance departments provide an independent review of credit requests before presentations to the Management Credit Committee. In assessing the quality of obligors, Nova MBL uses a credit rating model which considers both financial and non-financial parameters. The credit rating model has twelve rating scales, ranging from **AAA** to **D,** which are categorised into four grades (investment grade (**AAA** to **BBB)**, standard grade (**BB+** to **BB-**), non-investment grade (**B** to **B-**) and default grade (**CCC to D**). According to the Bank's credit rating model, 91% (FYE 2019: 41%) of the obligors were in the investment-grade category and 9% (FYE 2019: 41%) were categorised as standard grade obligors as at the FYE 2020. In our view, the assigned ratings do not fully reflect the risk profile of some of the obligors. Nevertheless, as at the same date, all credit facilities were performing and secured largely by cash and corporate guarantees.

Figure 3: Obligor Risk Profile (FYE 2019 and FYE 2020)



Market Risk: Nova MBL has a market risk management department that assesses, monitors, manages and reports on its market risk-related activities. Nova MBL manages market risk (changes in interest rates, foreign exchange and equity prices) by ensuring overall exposure is maintained at levels consistent with available capital. Market risk is monitored and controlled through tools such as hedge investments, position limits, value at risk metrics and concentration limits. The trading portfolio is also stress-tested monthly to estimate vulnerability to market risk. A 100 basis points rise in the prevailing interest rate and the foreign exchange rate would have resulted in a loss of ₦1.03 million (0.01% of shareholders' funds) and ₦110.1 million (0.5% of shareholders' funds) respectively in the Bank's trading book.

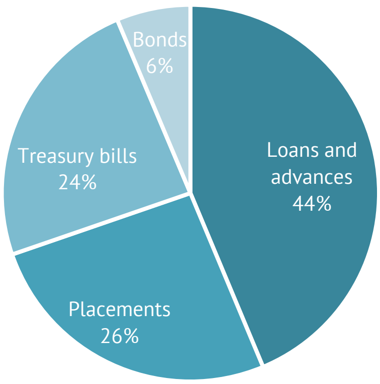
Operational Risk: Nova MBL is exposed to operational risk through its people, systems and processes. Operational risk is determined using the CBN recommended Basic Indicator Approach and the risk management department provides oversight for operational risk exposures of the Bank. Nova MBL's operational risk policies are reviewed at a maximum interval of three years in line with CBN Guidelines, but minor updates can be incorporated on an annual basis. During the year under review, Nova MBL did not pay any fine for any contravention of regulatory policies compared to the penalty of ₦2 million paid in the prior year.

We consider the risk management framework of Nova MBL adequate for the current level of business risks, albeit relatively untested given the Bank's short operating history. We believe that the macroeconomic headwinds in Nigeria will test the resilience of the Bank's risk management framework in the short to medium term. In 2021, the Bank plans to increase staffing to reduce key man risks and improve automation to strengthen risk management's systems and processes.

EARNINGS

In the financial year ended 31 December 2020, Nova Merchant Bank Limited's gross earnings grew by 127.9% to ₦13.2 billion, driven by the growth in the Bank's loan portfolio and larger fixed income securities portfolio. On the back of an enlarged earning asset base, interest income rose significantly by 112.1% year-on-year to ₦9.6 billion. In particular, during the year under review, interest income from the loan portfolio doubled to ₦4.2 billion and singly contributed 43.8% (FY 2019: 46.7%) to total interest income. Similarly, interest income from placements and fixed income securities rose by 420% and 49% respectively year-on-year and reflected the Bank's business expansion in the period under review.

Figure 4: Interest Income Composition for FY 2020

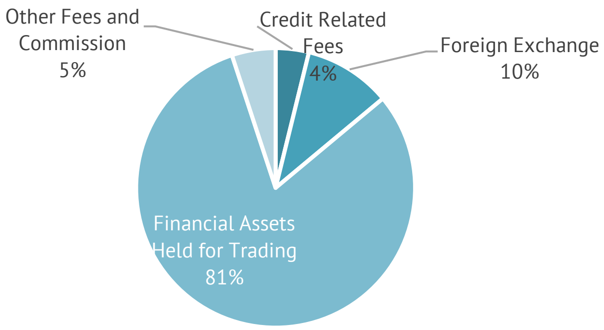


During FY 2020, the Bank's interest expense increased by 206.5% to ₦7.2 billion mainly on account of the larger expensive term deposits base despite the low interest environment in the review period. Although the ₦10 billion bond issued during the year provided additional liquidity, the associated costs, coupled with the interbank takings (recorded for the first time since operations commenced in 2017) exacerbated the interest expense. Thus, the Bank's net interest spread (NIS) dipped to 25.2% (FY 2019: 48.3%) and significantly lower than Rand MBL's 65.7% but stood higher than the 23.5% recorded by Coronation MBL . Nova MBL's net interest margin (measured as net interest income divided by average earning assets) also recorded a similar deterioration at 1.4% in the FY 2020 (FY 2019: 3.5%). Subsequent to the year end, in Q1 2021, Nova MBL's NIS further declined to 16.4%, depressed by the gradual rise in the prevailing interest rate which increased the interest expense. However, the heightened competition in the top tier corporate lending space, where Nova MBL predominantly plays kept a lid on the interest income. We expect to see such patterns of higher interest expense dampening interest income in the short term given the expectation of a further increase in the prevailing interest rate.

Nova MBL's loan loss expense declined by 7.7% to ₦72.7 million to account for 0.8% (FY 2019: 1.7%) of interest income, given the maturity of some significant contingent obligations and the reversal of the associated provisions during FY 2021. Overall, the Bank's fund-based income improved to ₦2.4 billion, an 11.6% growth from the prior year.

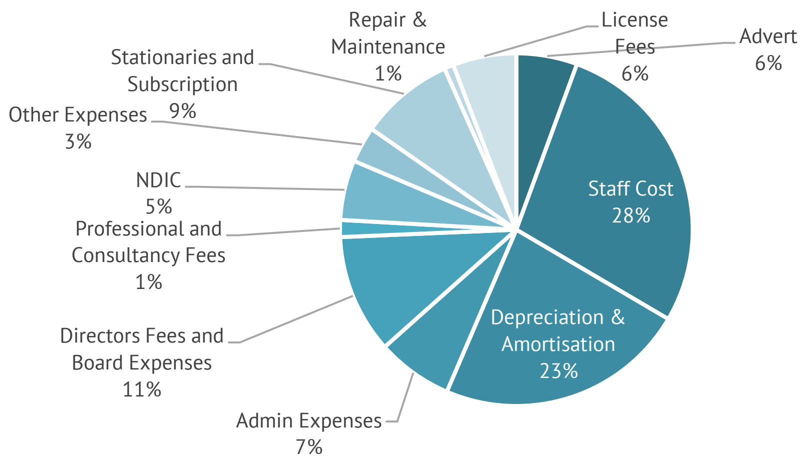
Nova MBL generates ancillary income mainly from securities trading and credit-related transactions. During FY 2020, ancillary income grew by 183% to ₦3.7 billion and accounted for 28% of gross earnings, as the Bank leveraged the prevailing volatilities in the fixed income space. Thus, net gains from investment securities trading increased by 287% to ₦3 billion and accounted for a significant 81% of non-interest income, connoting a strong treasury capability. However, we are concerned about the sustainability of this source of earnings given the high staff turnover in the treasury unit. The naira devaluation recorded during the year under review resulted in a 50% increase in foreign exchange revaluation gains to ₦370 million. However, the heightened competition in the lending space also moderated credit-related fees and commissions which dipped by 20% to ₦320.3 million and accounted for 4% of non-interest income in FY 2020. Reflective of the growth in ancillary income, Nova MBL's non-interest income to total assets improved slightly to 1.5% (FY 2019: 1.3%) and marginally lower than Coronation MBL's 1.8% and significantly lower than Rand MBL's 4.8%.

Figure 5: Breakdown of Non-interest income



In the FY 2020, Nova MBL's operating expenses (OPEX) grew by 37.3% to ₦2.6 billion, reflecting the cost profile of a financial institution in its growth phase in addition to inflationary pressure. Despite the cost-saving opportunities created by the pandemic, expenses related to the bond issuance and the establishment of the securities subsidiary together with the recruitment of additional staff resulted in higher OPEX. Notwithstanding, the Bank's cost-to-income ratio (CIR) improved to 43% from 55.3% in the prior year on the back of improved earnings, lower than 51.2% recorded by Coronation MBL but higher than Rand MBL's 39.2%. We expect higher OPEX in the near term due to inflationary pressures and growth plans of the Bank.

Figure 6: Breakdown of Operating Expenses in FY 2020



During the year under review, Nova MB's profit before tax amounted to ₦3.4 billion, a 125.8% year-on-year growth as the spike in gross earnings moderated the impact of the higher operating expenses. However, pre-tax return on average assets (ROA) dipped to 2% (FY 2019: 2.4%) as the asset growth was more significant relative to the increase in profit before tax. Nonetheless, the Bank recorded a higher pre-tax return on average equity (ROE) of 16.3%, almost double the 8.2% in the prior year. Nova MBL's profitability metrics compare well with peers - Coronation MBL's ROA and ROE of 1.4% and 16.3% respectively, albeit lower than Rand MBL's 6% (ROA) and 19.6% (ROE). Nevertheless, Nova MBL's ROE was higher than the 13.2% average inflation rate recorded in the year under review. We consider the Bank's profitability to be good. However, we anticipate only a moderate improvement in Nova MBL's profitability metrics in FY 2021 given Nigeria's slowly recovering macroeconomy which subdues performance. In line with our expectations, Nova MBL's unaudited accounts as at 31 March 2021 indicates annualized pre-tax ROA of 0.8% and annualized pre-tax ROE of 11.6%.

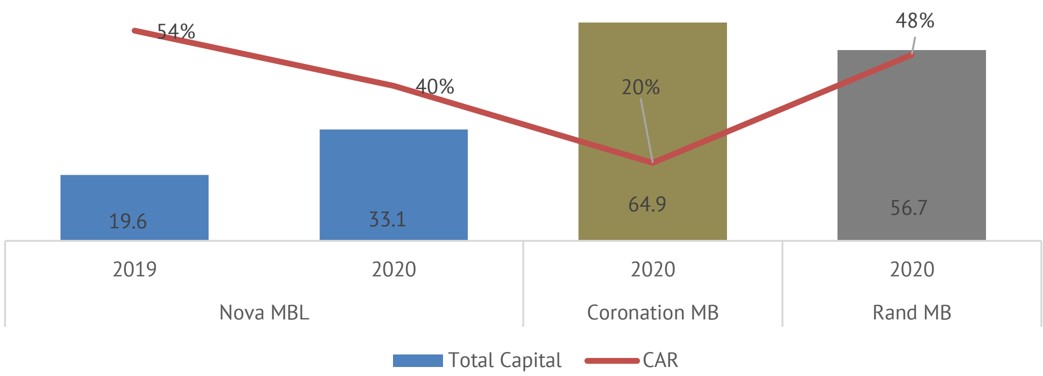
CAPITAL ADEQUACY

As at 31 December 2020, the Bank's tier 1 capital stood at ₦22.7 billion, 18% growth from the prior year due to the higher profit recorded and the resultant reserve accretion. At this level, the Bank's tier 1 capital was higher than the ₦15 billion regulatory minimum for merchant banks operating in Nigeria. As at the same date, Nova MBL's tier I capital to risk-weighted assets ratio stood at 29.66%, albeit significantly lower than the 53.57% recorded in the previous year, due to the 113.4% growth in the risk-weighted assets. As at 31 December 2020, the Bank's tier II capital stood at ₦10.4 billion, (FYE 2019: ₦247.5 million) due to the successful issuance of the ₦10 billion 7-year bond.

As at the FYE 2020, the Nova MBL's adjusted capital, computed in line with Basel II principles, funded 39.5% of its risk-weighted assets, a significant decline from 54.3% in the prior year as the Bank ramped up risk assets. Nonetheless, the capital adequacy ratio (CAR) remains above the 10% minimum threshold of the Central Bank of Nigeria, the 19.9% recorded by Coronation MBL but lower than Rand MBL's 47.5%.

We consider Nova MBL's capital to be good for current business risks. However, as the Bank further expands its risk asset portfolio as part of measures to optimise the balance sheet and deliver good returns to shareholders, we believe more pressure will be exerted on its capital. As a result, in the near term, we anticipate a further decline in the CAR, albeit, higher than the regulatory threshold and will remain sufficient for business risks.

Figure 7: Shareholders' Fund (in ₦'billion)and Capital Adequacy Ratio (CAR) in %



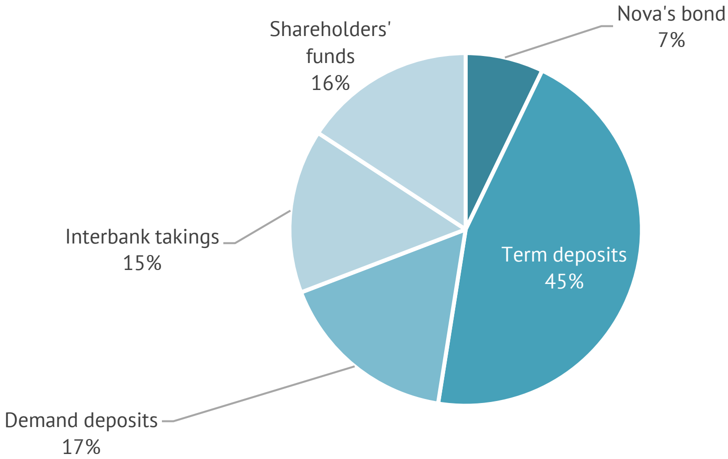
LIQUIDITY AND LIABILITY GENERATION

Nova Merchant Bank Limited is funded mainly by deposit liabilities, borrowings and shareholders' funds. Based on regulations, deposit liability generation for merchant banks is predominantly constrained to interest-rate sensitive and costly sources compared to cheap retail deposits available to commercial banks. During the year under review, Nova MBL's deposit liabilities (excluding interbank takings) grew by 121% to ₦89.6 billion as at the FYE 2020. Deposit growth was most prominent in the relatively expensive local currency (LCY) term deposits of ₦65.5 billion, which accounted for 59% of total deposit liabilities and funded 26.5% of total assets and contingents as at FYE 2020. Nevertheless, the Bank's LCY low-cost demand deposits grew significantly by 236.9% to ₦21.4 billion to fund 8.7% of the enlarged asset base. The substantial growth in LCY demand deposits in the review period caused Nova MBL's deposit mix (low-cost to high-cost local currency deposits ratio) to improve to 24:76 from 16: 84 in the prior year, albeit lower than Coronation MBL's 29: 71 and Rand MBL's 30:70 ratio.

The Bank's foreign currency (FCY) deposits grew on a year-on-year basis by 705.8% to ₦2.6 billion as at the FYE 2020, supported by aggressive marketing of FCY deposit products and the naira devaluation induced demand for FCY savings products. As at FYE 2020, Nova MBL's FCY deposits were sufficient to fund 24% of FCY loans. When we add the FCY borrowings, coverage improves to 223% which we consider satisfactory. We expect FCY deposits to further grow in the near term, hinged on the Bank's plans to onboard businesses with revenue in foreign currencies such as export-oriented agribusinesses.

The Bank's improved funding mix during the year under review translated to an estimated weighted average cost of funds (WACF) of 6.3%, down from 9.1% in the prior period. In addition, the prevailing low interest rate environment moderated the impact of the interbank takings of ₦21.7 billion and the ₦10 billion medium-term bond issued during the year under review. Nevertheless, as at the FYE 2020, NovaMBL's interbank ratio (placements to takings) stood at 22%, largely due to a transaction consummated with another commercial bank during the year under review. As at the same date, Nova MBL's WACF was higher than the 4.8% and 4% recorded by Coronation MBL and Rand MBL respectively during the year under review. We anticipate a gradual increase in the WACF for FY 2021 as the prevailing interest rates rise.

Figure 8: Nova MB's Funding Mix (FYE 2020)



Nova MBL's deposit base is concentrated with the top 10 clients accounting for 61.4% of total deposit liabilities as at FYE 2020. This was a marginal improvement from the prior year when 69.7% of the total deposit liabilities was sourced from 10 clients. Although the concentrated deposit base is typical of merchant banks in the early years of operations, we believe that Nova MBL could be negatively impacted should it be required to repay any of the top depositors without an adequate replacement.

During the year under review, Nova MBL's liquidity profile improved moderately with liquid assets of predominantly treasury bills accounting for 69% (FYE 2019: 61.9%) of total LCY deposits and higher than the regulatory minimum of 20% for merchant banks. Nova MBL's asset and liability profile exhibit maturity mismatches. As at the FYE 2020, only loans in the 3-12 months maturity bucket were adequately funded by customer deposits with the same maturity. As at the same date, the Bank had no customer deposits maturing beyond a year to fund the longer-tenor loans which amounted to ₦13.3 billion. Nevertheless, Nova MBL's pool of liquid assets and available capital could adequately fund loan exposures above one year. Moreover, the typical pattern of rollovers of term deposits by Nigerian investors provides some measure of comfort. In our opinion, the Bank's liquidity position is good with an adequate ability to refinance.

OWNERSHIP, MANAGEMENT & STAFF

Nova Merchant Bank Limited is owned by a dominant individual shareholder and six private institutions. As at 31 December 2020, the shareholding structure remained unchanged with the following accounting for 98% of the 16 million shares issued by the Bank.

Table 3: Significant Shareholders as at 31 December 2020

Shareholder	Percentage of Shareholding
Mr. Phillips Oduoza (Direct and Indirect Holdings)	50.494%
Carbon Commodities DMCC	24.753%
Five Star Associate Limited	12.377%
Afriglobal Investment Holding	12.377%
Total	**100%**

Nova MBL is governed by an eight-member Board of Directors which comprise two Executive Directors and six Non-Executive Directors (four of whom are Independent Non-Executive Directors). Mr Phillips Oduoza is the Chairman of the Board which has four standing committees (the Board Audit Committee; the Board Finance and General Purpose Committee; the Board Nomination and Governance Committee; and the Board Credit and Risk) for effective oversight activities.

There were changes in the composition of the Board during the year under review. Mr Ayodeji Adigun who served as an Executive Director retired from Nova MBL in June 2020. Mr Anya Duroha resigned from his position as the Managing Director and Chief Executive Officer in October 2020. Subsequently, Mr Nath Ude who hitherto joined the Bank in July 2020 as the Deputy Managing Director became the Managing Director and Chief Executive Officer. Mrs Funke Okoya also joined the Board as an Executive Director with purview over business development.

Mrs Funke Okoya is the Executive Director of Business Development at Nova Merchant Bank Limited where she is responsible for Corporate Banking, Energy and Telecommunications, Channels and Digital Banking Divisions. She has over two decades of professional experience covering Corporate and Investment Banking, Commercial Banking, Credit and Risk Management, Bank Operations, Customer Services, Technology, Project Management, Strategy and Communications at United Bank for Africa Plc, Access Bank Plc, Coronation Merchant bank Limited, Ecobank Nigeria Limited, among others. Mrs Funke Okoya is a Business Administration graduate of the University of Lagos and holds an MBA from the Business School Netherlands. She is an alumnus of INSEAD Business School where she attended its Advanced Corporate Finance Programme. She is a certified Fellow and council member of the Association of Investment Advisers and Portfolio Managers.

During the year under review, Nova MBL employed an average of 55 persons (FY 2019: 50 persons) comprising two executive management staff, 16 management staff and 37 non-management staff. While the increase in staff number was marginal, some resignations elicited replacements of employees in a higher cadre. As a result, staff-related expenses increased by 21.6% to ₦719.5 million and translated to staff cost per employee of ₦13.1 million, 10.6% higher than the prior year. Given the improved performance recorded during the year, net earnings per staff improved by 60.8% to ₦109.2 million and covered average staff costs 8.4 times (FY 2019:

5.7 times). The Bank's net earnings coverage of staff costs surpassed that of Coronation MBL (6.5 times) and Rand MBL (4.1times) as at the same date.

We are concerned about the high turnover in the senior management team, given that the Bank has appointed three different Managing Directors despite operating for less than four years. Our concerns are mitigated by the quality of new recruits and the initiatives introduced to improve staff welfare.

MARKET SHARE

Despite the dominance of commercial banks in Nigeria's Banking Industry over merchant banks, Nova MBL's market share continues to grow over the last three years. Nova MBL's net earnings and pre-tax profits accounted for 11% and 12% respectively of the merchant banking industry net earnings and pre-tax profits. Deposit liabilities which grew substantially by 121% to ₦89.6 billion, accounted for 20% of the Industry's deposit liabilities. Whilst the Bank has maintained a fast-growing profile, it continues to face heightened competition from commercial banks as well as its peers in the merchant banking sub-sector.

Table 4: Share of Total Banking Industry (Nova versus Peers)

	Nova MBL 2019	Nova MBL 2020	Coronation MBL 2020	Rand MBL 2020
LCY Deposits	0.21%	0.40%	0.84%	0.14%
Total Assets and Contingents	0.22%	0.48%	0.93%	0.42%
Total Loans & Advances (Net)	0.18%	0.29%	0.71%	0.31%
Net Earnings	0.13%	0.23%	0.44%	0.67%
Pre-tax Profit	0.16%	0.44%	0.74%	1.39%

OUTLOOK

In 2021, Nova MBL plans to disburse longer tenured loans, a bold shift from short-dated loans predominant in the merchant banking industry in order to earn a larger and more assured interest income. Therefore, the Bank will require more stable longer-tenured funds. Top-tier corporates and the top end of the MSMEs with a focus on agribusinesses (and a bias for agro-exports) will be the Bank's preferred obligors. In addition, Nova MBL plans to grant more long tenured loans to operators in the oil and gas downstream sector as well as COVID-19 resilient sectors such as telecommunications, FMCG and logistics. Investments in financial assets will also be prioritised to take advantage of the increasing yield environment.

We expect capital to remain a good buffer for business risks supported by the bond issued inthe FY 2020 and accretion to reserves following improved profitability. Liquidity should also remain adequate. However, profitability may come under pressure with additional interest expense as stable funding is sourced. Nevertheless, Agusto & Co. hereby attach a '**stable**' outlook to the rating of Nova Merchant Bank Limited.

FINANCIAL SUMMARY

NOVA MERCHANT BANK LIMITED

	STATEMENT OF FINANCIAL POSITION AS AT	31-Dec-20		31-Dec-19		31-Dec-18	
		₦'000		₦'000		₦'000	
	ASSETS						
1	Cash & equivalents						
2	Government securities	56,953,583	23.0%	16,046,552	16.6%	14,243,090	50.4%
3	Money Market Placements	19,943,683	8.1%	7,035,382	7.3%	3,883,786	13.7%
4	Quoted investments						
5	Placements with discount houses						
6	LIQUID ASSETS	76,897,266	31.1%	23,081,934	23.8%	18,126,876	64.1%
7	BALANCES WITH NIGERIAN BANKS	4,850,438	2.0%	1,775,680	1.8%	131,941	0.5%
8	BALANCES WITH BANKS OUTSIDE NIGERIA	4,799,703	1.9%	1,799,304	1.9%	1,063,853	3.8%
9	Direct loans and advances - Gross	50,069,916	20.3%	29,316,534	30.2%	2,428,797	8.6%
10	Less: Cumulative loan loss provision	(98,375)	0.0%	(31,030)	0.0%	(980)	0.0%
11	Direct loans & advances - net	49,971,541	20.2%	29,285,504	30.2%	2,427,817	8.6%
12	Advances under finance leases - net						
13	TOTAL LOANS & LEASES - NET	49,971,541	20.2%	29,285,504	30.2%	2,427,817	8.6%
14	INTEREST RECEIVABLE						
15	OTHER ASSETS	7,843,826	3.2%	3,832,677	4.0%	1,000,336	3.5%
16	DEFERRED LOSSES	443,498	0.2%	443,497	0.5%	294,497	1.0%
17	RESTRICTED FUNDS	35,170,012	14.2%	1,286,185	1.3%		
18	UNCONSOLIDATED SUBSIDIARIES & ASSOCIATES	415,000	0.2%	150,000	0.2%		
19	OTHER LONG-TERM INVESTMENTS			280,871	0.3%		
20	FIXED ASSETS & INTANGIBLES	1,868,587	0.8%	1,869,647	1.9%	1,940,819	6.9%
21	**TOTAL ASSETS**	**182,259,871**	**73.7%**	**63,805,299**	**65.8%**	**24,986,139**	**88.4%**
22	TOTAL CONTINGENT ASSETS	64,974,259	26.3%	33,117,124	34.2%	3,281,426	11.6%
23	**TOTAL ASSETS & CONTINGENTS**	**247,234,130**	**100%**	**96,922,423**	**100%**	**28,267,565**	**100%**
	CAPITAL & LIABILITIES						
24	TIER 1 CAPITAL (CORE CAPITAL)	22,703,156	9.2%	19,312,278	19.9%	17,611,431	62.3%
25	TIER 2 CAPITAL	10,395,896	4.2%	247,533	0.3%		
26	MEDIUM TERM BORROWINGS						
27	Demand deposits	21,427,407	8.7%	6,359,343	6.6%	1,481,449	5.2%
28	Savings deposits						
29	Time deposits	65,544,720	26.5%	33,826,012	34.9%	5,013,024	17.7%
30	Inter-bank takings	21,713,953	8.8%				
31	TOTAL DEPOSIT LIABILITIES - LCY	108,686,080	44.0%	40,185,355	41.5%	6,494,473	23.0%
32	Customers' foreign currency balances	2,639,702	1.1%	327,585	0.3%		
33	TOTAL DEPOSIT LIABILITIES	111,325,782	45.0%	40,512,940	41.8%	6,494,473	23.0%
34	INTEREST PAYABLE						
35	OTHER LIABILITIES	37,835,037	15.3%	3,732,548	3.9%	880,235	3.1%
36	**TOTAL CAPITAL & LIABILITIES**	**182,259,871**	**73.7%**	**63,805,299**	**65.8%**	**24,986,139**	**88.4%**
37	TOTAL CONTINGENT LIABILITIES	64,974,259	26.3%	33,117,124	34.2%	3,281,426	11.6%
38	**TOTAL CAPITAL, LIABILITIES & CONTINGENTS**	**247,234,130**	**100%**	**96,922,423**	**100%**	**28,267,565**	**100%**
	BREAKDOWN OF CONTINGENTS						
39	Acceptances & direct credit substitutes			27,760,378	28.6%	3,115,216	11.0%
40	Guarantees, bonds etc..	1,073,804	0.4%	2,123,301	2.2%	116,210	0.4%
41	Short-term self liquidating contingencies	63,900,455	25.8%	3,233,445	3.3%	50,000	0.2%

NOVA MERCHANT BANK LIMITED

	STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED	31-Dec-20 ₦'000		31-Dec-19 ₦'000		31-Dec-18 ₦'000	
42	Interest income	9,605,681	72.4%	4,529,392	77.8%	1,876,519	68.1%
43	Interest expense	(7,181,076)	-54.2%	(2,343,268)	-40.3%	(373,347)	-13.5%
44	Loan loss expense	(72,696)	-0.5%	(78,766)	-1.4%	(1,148)	0.0%
45	NET REVENUE FROM FUNDS	2,351,909	17.7%	2,107,358	36.2%	1,502,024	54.5%
46	ALL OTHER INCOME	3,654,774	27.6%	1,289,586	22.2%	878,949	31.9%
47	**NET EARNINGS**	**6,006,683**	**45.3%**	**3,396,944**	**58.4%**	**2,380,973**	**86.4%**
48	Staff costs	(719,527)	-5.4%	(591,602)	-10.2%	(453,315)	-16.5%
49	Depreciation expense	(593,319)	-4.5%	(294,523)	-5.1%	(145,293)	-5.3%
50	Other operating expenses	(1,268,536)	-9.6%	(993,933)	-17.1%	(821,774)	-29.8%
51	TOTAL OPERATING EXPENSES	(2,581,382)	-19.5%	(1,880,058)	-32.3%	(1,420,382)	-51.5%
52	PROFIT (LOSS) BEFORE TAXATION	3,425,301	25.8%	1,516,886	26.1%	960,591	34.9%
53	TAX (EXPENSE) BENEFIT	(34,424)	-0.3%	133,831	2.3%	190,394	6.9%
54	**PROFIT (LOSS) AFTER TAXATION**	**3,390,877**	**25.6%**	**1,650,717**	**28.4%**	**1,150,985**	**41.8%**
55	NON-OPERATING INCOME (EXPENSE) - NET						
56	DIVIDEND						
57	**GROSS EARNINGS**	**13,260,455**	**100%**	**5,818,978**	**100%**	**2,755,468**	**100%**
58	AUDITORS	PWC		PWC		PWC	
59	OPINION	CLEAN		CLEAN		CLEAN	

	KEY RATIOS	31-Dec-20	31-Dec-19	31-Dec-18
	EARNINGS			
60	Net interest margin	25.2%	48.3%	80.1%
61	Loan loss expense/Interest income	0.8%	1.7%	0.1%
62	Return on average assets & contingents (Pre - tax)	2.0%	2.4%	4.2%
63	Return on average equity (Pre - tax)	16.3%	8.2%	5.6%
64	Operating Expenses/Net earnings	43.0%	55.3%	59.7%
65	Gross earnings/Total assets & contingents (average)	7.7%	9.3%	11.9%
	EARNINGS MIX			
66	Net revenue from funds	39.2%	62.0%	63.1%
67	All other income	60.8%	38.0%	36.9%
	LIQUIDITY			
68	Total loans & leases - net/Total lcy deposits	8.1%	29.3%	-203.9%
69	Liquid assets/Total lcy deposits	69.0%	61.9%	281.1%
70	Demand deposits/Total lcy deposits	19.7%	15.8%	22.8%
71	Savings deposits/Total lcy deposits	Nil	Nil	Nil
72	Time deposits/Total lcy deposits	60.3%	84.2%	77.2%
73	Inter-bank borrowings/Total lcy deposits	20.0%	Nil	Nil
74	Interest expense - banks/Interest expense	5.2%	Nil	Nil
75	**NET FOREIGN CURRENCY ASSETS (LIABILITIES)**	Nil	Nil	Nil

NOVA MERCHANT BANK LIMITED

	KEY RATIOS CONT'D	31-Dec-20	31-Dec-19	31-Dec-18
	ASSET QUALITY			
76	Performing loans (₦'000)	50,069,916	29,316,534	2,428,797
77	Non-performing loans (₦'000)	Nil	Nil	Nil
78	Non-performing loans/Total loans - Gross	Nil	Nil	Nil
79	Loan loss provision/Total loans - Gross	0.2%	0.1%	0.0%
80	Loan loss provision/Non-performing loans	Nil	Nil	Nil
81	Risk-weighted assets/Total assets & contingents	31.5%	67.2%	28.8%
	CAPITAL ADEQUACY			
82	Adjusted capital/risk weighted assets (Basel I)	27%	28%	204%
83	Tier 1 capital/Adjusted capital	102%	101%	100%
84	Total loans (net)/Adjusted capital	2.35	1.61	0.15
85	Capital unimpaired by losses (₦'000)	22,321,846	19,116,314	17,316,934
	STAFF INFORMATION			
86	Net earnings per staff (₦'000)	84,601	67,939	56,690
87	Staff cost per employee (₦'000)	10,134	11,832	10,793
88	Staff costs/Operating expenses	27.9%	31.5%	31.9%
89	Average number of employees	71	50	42
90	Average staff per office	71	50	42
	OTHER KEY INFORMATION			
91	Legal lending limit(₦'000)	11,160,923	9,558,157	8,658,467
92	Other unamortised losses(₦'000)	NONE	NONE	NONE
93	Unreconciled inter-branch items (₦'000) DR/(CR)	NONE	NONE	NONE
94	Number of offices	1	1	1
95	Age (in years)	3	2	1
96	Government stake in equity (Indirect)	Nil	Nil	Nil
	MARKET SHARE OF INDUSTRY TOTAL	**Estimate**	**Actual**	**Actual**
97	Lcy deposits (excluding interbank takings)	0.4%	0.2%	0.0%
98	Total assets & contingents	0.5%	0.2%	0.1%
99	Total loans & leases - net	0.3%	0.2%	0.0%
100	Non interest income	0.3%	0.1%	0.1%

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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