Nova Merchant Bank Limited

Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Nova Merchant Bank Limited

A financial institution of satisfactory financial condition and adequate capacity to meet its obligations.

Rating Assigned:

Bbb

Outlook: Stable
Issue Date: 28 March 2019
Expiry Date: 30 June 2020
Previous Ratings: N/A

Industry: Banking

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RATING RATIONALE

The rating assigned to Nova Merchant Bank Limited ('**NovaMBL**' or '**the Bank**') reflects its strong capitalization ratios, acceptable asset quality and strong liquidity profile. The rating takes into cognisance the Bank's limited financial track record, though it is led by an experienced management team. The subdued macroeconomic environment and its attendant impact on the banking Industry is also a rating concern.

Nova Merchant Bank Limited is a new entrant in the Nigerian merchant banking space, a segment of the banking industry that has witnessed notable entrants over the last five years. The Bank's strategy largely revolves around its digital banking platform - the "Intellect Digital Core", an omnichannel core banking application that allows it offer multiple solutions to customers, using modern technology. In addition, NovaMBL is leveraging its new and unencumbered banking franchise (void of legacy issues) and a lean structure to compete with existing players.

The 2018 financial year marked NovaMBL's first full year in operation and the commencement of its core lending business. The Bank grew its asset base from ₦18 billion in 2017 to ₦28.3 billion as at 31 December 2018, although its balance sheet remains the smallest of the five licensed merchant banks in Nigeria. NovaMBL's loan portfolio which was created in the last quarter of the review year, stood at ₦2.4 billion with all credits performing as at 31 December 2018. Subsequent to year end, gross loans & advances further increased to ₦4.6 billion as at February 2019. In creating risk assets, the Bank targets mid-sized obligors in the oil & gas, manufacturing, utilities & infrastructure, trade & services, fast moving consumer goods (FMCG) and public sectors, providing trade lines and working capital financing. We are unable to ascertain NovaMBL's risk management efficiency as it remains untested given the Bank's age.

Nova Merchant Bank Limited is well capitalised for its current business risks as shareholders' funds of ₦17.6 billion stood above the regulatory threshold of ₦15 billion. Risk adjusted capital adequacy ratio computed using Basel II tenets was 228.64% as at FYE2018, significantly above the 10% regulatory minimum for merchant banks. As NovaMBL deploys its capital to creating risk assets, we expect its CAR to moderate gradually, albeit within acceptable levels in the medium term.

Customer deposits grew from a nil position in 2017 to ₦6.5 billion as at 31 December 2018, funding 23% of the Bank's asset base. Being wholesale based with deposit liabilities skewed towards costly term deposits, NovaMBL's weighted average cost of fund (WACF) stood at circa 10%. However, a strong liquidity profile was maintained during the review period, with liquid assets to total local currency (LCY) deposits of 281.1% as at FYE2018, significantly above the regulatory liquidity ratio minimum of 20%. In the short term, NovaMBL plans to use its liquid assets to generate funds for asset creation through repurchase agreements (REPOs) at the interbank market.

Though pressured by high funding and operating costs (largely start-up expenses), Nova Merchant Bank's profitability was upheld by its treasury operations and ancillary activities (trading and trade related services) given that the Bank commenced lending in the last quarter of 2018. We expect a more diversified earnings base in 2019. Pre-tax profits strengthened by 128.6% to ₦960.6 million and translated to a pre-tax return on average assets (ROA) and pre-tax return on average equity (ROE) of 4.2% and 5.6% respectively. We consider the Bank's profitability to be weak, though reflective of its age. We believe as business grows, profitability will improve.

Agusto & Co's outlook for Nova Merchant Bank Limited is stable hinged on our expectations that performance will be upheld by a strong capital base, good liquidity profile and improved profitability in the near term. On this basis, we hereby assign a **Bbb** rating to Nova Merchant Bank Limited.

Strengths

- Strong capitalisation
- Strong liquidity profile
- Experienced management team

Weaknesses

- Limited track record
- Weak profitability given its status as a new bank
- Sector and obligor concentration in the loan book
- Dominant shareholder

Challenges

- Lingering weaknesses in the Nigerian macroeconomic environment which threatens asset quality
- Growing market share in the merchant banking space and entire banking industry.
- The political environment and uncertainties in policy directions by the re-elected administration

Table 1: Financial Data

	December 2018	December 2017
Total Assets & Contingents	₦28.3 billion	₦17.9 billion
Total Local Currency Deposits	₦6.5 billion	nil
Net Earnings	₦2.4 billion	₦1.2 billion
Return on Average Assets & Contingents (ROA)	4.2%	7.0%*
Return on Average Equity (ROE)	5.6%	7.6%*

**Annualised*

PROFILE

Nova Merchant Bank Limited ("NovaMBL" or "the Bank") was incorporated in May 2017 to carry out merchant banking business in Nigeria. In December 2017, the Bank obtained its merchant banking license from the Central Bank of Nigeria (CBN), making it the fifth licensed merchant bank in Nigeria as at FYE2018. The principal activities of the Bank during the 2018 financial year were the provision of merchant banking services comprising corporate banking and money market activities (trading and holding marketable securities such as treasury bills and government bonds). Going into 2019 and beyond, NovaMBL is leveraging the competitive advantage afforded by its merchant banking license to provide additional services covering wholesale banking, investment banking, asset and wealth management.

NovaMBL's strategy adopts an insight-data driven approach to winning in a highly competitive industry by focusing on pain points in prospective and existing clients' businesses and providing innovative solutions to these challenges. In creating risk assets, the Bank targets the Fast-Moving Consumer Goods (FMCG), Oil & Gas, Trade & Services, Utilities & Infrastructure, Commodities & Agric and Public sectors. NovaMBL's funding strategy is guided by a five-year (2018-2022) liability generation plan that highlights major funding sources as corporates & high net worth individuals deposits, interbank takings, development financial institutions, commercial papers, corporate bonds as well as its asset management subsidiary.

Nova Bank's core banking business is structured into three divisions:

- Investment Banking: Asset Management, capital market, mergers & acquisitions, advisory, corporate finance, project finance and wealth management
- Treasury
- Wholesale Banking which will target Fast Moving Consumer Goods (FMCG), Public Sector, Oil & Gas, Trade & Services, Utilities & Infrastructure and Commodities & Agriculture.

In addition to these core divisions, departments such as Risk Management, Strategy, Information & Technology, Operations, Internal Control, Finance, Compliance, Corporate Services, Human Capital Management and Communication, Marketing & Branding provide support at the back office.

Nova Merchant Bank Limited's head office is located at 23, Kofo Abayomi Street, Victoria Island, Lagos.

Subsidiaries

As at FYE2018, Nova Merchant Bank Limited had no existing subsidiaries. However, the sum of ₦318.6 million was invested as startup capital for two subsidiaries - NovaMBL Asset Management Limited and NovaMBL Securities Limited. Subsequent to year end 2018, the Bank also commenced the process of setting up a Trustee subsidiary. The proposed subsidiaries will operate from Lagos with principal activities in Fund & Portfolio Management, Financial Securities Trading and Trusteeship respectively. The subsidiaries are expected to be completed in 2019.

Table 2: Nova Merchant Bank Proposed Subsidiaries

Name of Subsidiary	Principal Activities	Proportion of Ownership Interests
NovaMBL Asset Management Limited	Fund & Portfolio Management	99%
NovaMBL Securities Limited	Trading in Financial Securities	99%

Information, Communication & Technology (ICT)

Nova Merchant Bank Limited deploys a range of software, hardware and communication solutions for daily operations. The software solutions, particularly its core banking application - "Intellect Digital Core" is used by internal and external customers. Intellect Digital Core (IDC), provided by India-based banking technology developer, Intellect Design Arena is an omnichannel application that allows integration with other systems to offer end to end solutions. NovaMBL is the first bank in Nigeria to adopt the full Intellect Digital Core banking application. The IDC application contains core trade, treasury, lending, anti-money laundering and internet & mobile banking modules, all on one platform. Other software applications used by the Bank are Oracle & Microsoft SQL for databases, NAPS, SWIFT and NIP among others. The Bank also uses Microsoft Office 365 for email correspondences and AVAYA IP telephony for Voice-over-IP (telephone) communication.

At NovaMBL's headquarters, there are endpoint systems (including desktop computers and laptops) and network equipment that provide connectivity to remote sites and form the hardware application of the Bank. Nova Bank has two remote tier III datacenter sites which house its IT infrastructure comprising:

- IBM Servers for the Core Banking Application
- HP Servers for other services or resources used by the Bank
- CISCO network devices for the network infrastructure
- Fortinet devices for the security infrastructure

The primary data center is located in Ikeja and a secondary data center in Lekki. At the primary data center, there are redundancies of equipment for network and security devices to ensure that services are always available with minimal disruptions.

Correspondent Banks

During the 2018 financial year, Nova Merchant Bank Limited maintained local banking relationship with United Bank for Africa (UBA) Plc and foreign banking relationships with UBA New York, Access Bank United Kingdom and First City Monument Bank United Kingdom.

Track Record of Performance

Nova Merchant Bank Limited's asset base stood at ₦28.3 billion as at 31 December 2018, reflecting a 57.1% growth year on year. The Bank's loan portfolio grew from a nil position in 2017 to ₦2.4 billion as at FYE2018 and all credits were performing as at same date. NovaMBL's shareholders' funds of ₦17.6 billion was above the ₦15 billion regulatory minimum for merchant banks operating in Nigeria and translated to a Basel II capital adequacy ratio of 228.64%, when weighted against risk assets, higher than the 10% regulatory threshold prescribed by the Central Bank of Nigeria. Customer deposits amounted to ₦6.5 billion as at end of 2018FY, funding 22.9% of the Bank's assets & contingents.

NovaMBL's profitability strengthened year on year in 2018 with a 128.6% spike in pre-tax profits to ₦960.6 million. This translated to a pre-tax return on average assets of 4.2% and a pre-tax return on average equity of 5.6% in the review period.

Table 3: Current Directors at Nova Merchant Bank Limited

Current Directors	Position/Designation	Shareholding (%)
Phillips Oduoza	*Chairman*	*50.493%**
Anya Duroha	*Chief Executive Officer/Managing Director*	*Nil*
Ayodeji Adigun	*Executive Director/Chief Operating Officer*	*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*

MANAGEMENT TEAM

Mr. Anya Duroha is the Managing Director/Chief Executive Officer at Nova Merchant Bank Limited. His appointment was confirmed by the Board effective January 1, 2019 (subject to regulatory confirmation which was obtained on February 13, 2019) after serving in an 'acting' capacity between August 30, 2018 and December 31, 2018. Preceding his appointment, Mr. Duroha was the Executive Director, Wholesale Bank, responsible for the development and management of NovaMBL's corporate banking relationships.

Mr. Anya Duroha has over 25 years' experience spanning many roles. Prior to joining Nova Merchant Bank Limited, he was Head, Business Banking at StanbicIBTC Bank where he managed the commercial and SME banking business in Nigeria. In that role, he was responsible for both relationship & portfolio management and implemented strategies that led to growth of the business. He served as Head, Corporate Banking at United Bank for Africa Plc; Head, Corporate Banking at Diamond Bank Plc and Head of Business Development (Designate) at Diamond Bank, United Kingdom at various times. In these roles, he managed portfolios in sectors such as manufacturing, agriculture, construction, oil & gas, infrastructure, aviation, power, maritime, telecommunications, fast moving consumer goods (FMCG) and structured trade finance.

Mr Anya Duroha holds an MSc in Banking & Finance from the University of Benin and a Bachelor of Engineering (B.Eng) in Civil Engineering from the University of Nigeria, Nsukka. He is an alumnus of Wharton Business School, University of Pennsylvania and Lagos Business School.

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

Ayodeji Adigun	*Executive Director/Chief Operating Officer*
Ayodeji Abimbola	*Group Treasurer*
Akinwale Olawoye	*Chief Compliance Officer*
Kelechi Uba-Osigwe	*Company Secretary/General Counsel*
Ifeanyi Chukwuonye	*Chief Financial Officer*
Chukwuka Chukwuma	*Head, Financial Institutions & Correspondent Banking*
Echezona Ezeoka	*Chief Audit Executive*
Emeka Uzomba	*Head, Investment Banking & Structured Lending*
Oluwatoyin Oguntuyi	*Head, Wholesale Bank*
Obiaajum Chimbo	*Acting Chief Risk Officer*

Analysts' Comments

Asset Quality

In the first full year of operations, Nova Bank grew its asset base by 57.1% to ₦28.3 billion (assets and off-balance sheet commitments). Growth was driven by increased customer deposits which strengthened the Bank's funding base. Liquid assets, comprising government securities and bank placements accounted for a significant portion of total assets & contingents at 64.1% as core lending activities commenced in the last quarter of the year.

Nova Merchant Bank Limited's lending strategy focuses on offering trade lines and working capital funding to obligors in selected sectors: oil & gas, commodity & agriculture, utility & infrastructure, fastmoving consumer goods (FMCG), public sector, trade & services and financial institutions. The Bank targets businesses with a minimum monthly turnover of $1 million or ₦3.6 billion annually for risk assets creation. In 2018, NovaMBL's loan portfolio grew from a nil position to ₦2.4 billion (gross) as at 31 December 2018, comprising two obligors within their target market. Approximately 40% of the Bank's gross loans was extended to one obligor in the manufacturing sector while 60% was classified under "general" in line with CBN's sectoral classification. These naira denominated credits were short tenured, trade linked transactions with tenors less than one year. As at February 2019, gross loans & advances further increased to ₦4.6 billion, comprising a total of six obligors. Additional loans were recorded in the oil & gas, trading and manufacturing sectors in the first quarter of 2019. The loan to the oil & gas sector was adequately cash collateralised.

Figure 1: Loan Book by Sector (FYE2018)

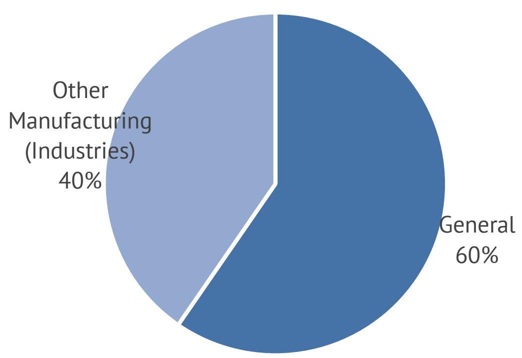
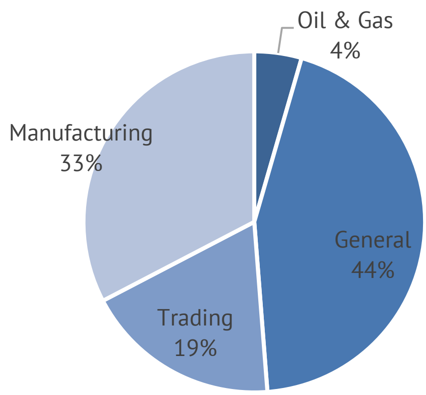


Figure 2: Loan Book by Sector (Feb 2019)



As part of NovaMBL's credit approval process, ratings are assigned using an internal credit rating model developed by the Bank and validated by PricewaterhouseCoopers (PWC). As at 31 December 2018, the rating model appraised both obligors as 'investment grade'. The extended loan book of ₦4.6 billion as at February 2019 comprised 79% in investment grade names and 21% in non-investment grade names. We consider a few of the assigned obligor ratings to be generous in view of the current operating climate in Nigeria.

As is typical of most merchant banks in Nigeria and given NovaMBL's age, the loan book was concentrated by sector and obligor. We acknowledge that the merchant banking license limits its users to wholesale (non-retail) banking; hence higher concentration levels are observed with merchant banks relative to the commercial banking counterparts. Notwithstanding, concentration risk that exists in the NovaMBL's loan book exposes it to probable deterioration in asset quality should one of these obligors default. We draw some comfort from adequate collaterals collected by the Bank as a risk management strategy. While further diversification in the Bank's loan portfolio is anticipated as it expands into other sectors within its universe, we believe concentration will remain in medium term.

As at FYE2018, NovaMBL's credits were performing, translating to a zero non-performing loans (NPL) ratio in the review period. We recognise that the Bank's risk management expertise remains untested as tenors of existing loans are yet to season.

We consider Nova Merchant Bank's asset quality to be acceptable. In 2019, NovaMBL targets a loan size of about ₦25 billion focusing on short dated transactions and medium tenured credits for selected names. This may be somewhat achievable, considering approved deals of over ₦30 billion in the pipeline. However, we are of the opinion that the fragile economic climate and uncertainties around the economic direction of the recently re-elected administration may impact on the Bank's ability to achieve its target. For off balance sheet transactions, Nova Bank is looking to expand its credit lines from foreign financial institutions in the 2019FY.

We expect Nova Merchant Bank to maintain a healthy loan book in the short term. As existing loans begin to season, we will be able to assess the Bank's risk management framework.

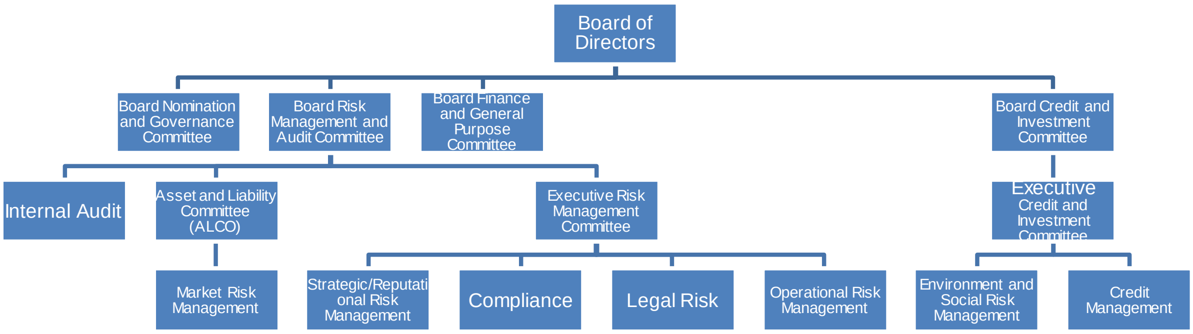
Risk Management

Nova Merchant Bank Limited adopts a moderate risk appetite in order to preserve capital and safeguard future returns to shareholders. A moderate risk profile implies that the Bank is willing to accept a lower level of potential losses or exposure, relative to other banks in the Industry.

Risk strategies and policies are set by the Board of Directors which is the highest approval authority for credit risks policies and credit facilities at Nova Merchant Bank Limited. These policies, which define acceptable levels of risk for day to day operations as well as the willingness of the Bank to assume risk, weighted against expected rewards, are detailed in the Bank's Enterprise Risk Management (ERM) Framework. As at date, all credit requests are presented to the full Board of Directors for final approval.

The Board carries out its oversight function through four standing committees namely: Board Risk Management & Audit Committee, Board Credit & Investment Committee, Board Nomination & Governance Committee and Board Finance & General-Purpose Committee. In line with best practice, the Chairman of the Board does not sit on any of these committees. At the management level, the Executive Committee, Risk Management Committee, Executive Credit & Investment Credit Committee and the Asset & Liability Committee are responsible for risk management.

Figure 3: NovaMBL's Risk Management Organogram



Credit Risk: In assessing credit risk, Nova Merchant Bank Limited uses an internally created rating model deployed on Microsoft excel. The risk rating model which has financial and non-financial matrices helps the Bank assign risk ratings to obligors from a rating scale of "**AAA**" to "**B-**". As a policy, NovaMBL's minimum acceptable rating is "**B**", below which the Bank is unwilling to lend. The Bank also accepts various forms of collateral to enhance facility ratings.

According to Nova Bank's internal rating model, all obligors granted loans & advances granted in the 2018 financial year were investment grade names. In addition, on and off-balance sheet exposures were adequately secured with cash, treasury bills, guarantees and debentures, providing an additional layer of comfort. While NovaMBL recorded a zero non-performing loan book, we believe that obligor and sector concentrations threaten asset quality as a downward trend in one or two of these obligors' or sectors' performances will have negative implications on the Bank's asset quality. However, approximately 60% of the Bank's loans as at FYE2018 were cash collateralised which insulates the Bank to some extent.

Market Risk: NovaMBL's trading and non-trading (banking) books are impacted by changes in interest rates and exchange rates which expose it to pricing and currency risks. The Bank uses the following tools to measure market risk in the trading book: position limit utilisation, marked to market (MTM) valuation, stop loss limit and sensitivity analysis while net interest income sensitivity analysis and repricing gap analysis are used for its banking books. Mitigants highlighted by the Bank include monitoring of internal limits for positions and currencies and holding low trading positions during periods of market volatility. Furthermore, daily stress testing is carried out on the Bank's trading portfolio and relevant business units are advised by the risk management team accordingly.

Operational Risk: NovaMBL uses the Basic Indicator Approach (BIA) to measure operational risk. The Bank's operational risk management framework involves various processes that identify, measure, mitigate and monitor risks. Subsequently, reports are generated and circulated to management. The function is currently carried out by the Acting Chief Risk Officer who reports to management. We recognise NovaMBL's efforts in deepening cyber security monitoring- a rising concern in the Industry.

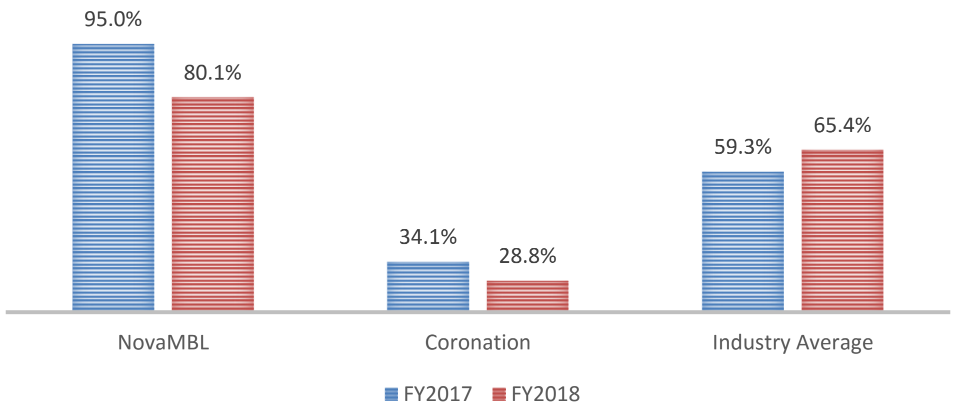
We consider Nova Merchant Bank's risk management framework to be adequate for its current level of business risk. However, it remains untested. As the Bank expands operations and deploys various platforms to serve clients, we expect a wider and automated risk management framework as well as an increase in its risk management staff strength which stood at two persons in 2018.

EARNINGS

During the 2018 financial year, Nova Merchant Bank Limited generated income from lending and investments in treasury bills & bonds. The Bank also earned fees and commissions from off balance sheet transactions and other auxiliary services offered to its clients. NovaMBL's gross earnings amounted to ₦2.8 billion in 2018, up by 125% year on year. Interest income strengthened (53.2% y/y), reflecting full year operations of the Bank and a diversified asset base to include loans & advances and off-balance sheet transactions. However, income from treasury bills & bonds dominated the Bank's interest income at 86%, given that core lending commenced in Q4, 2018. NovaMBL's relatively larger portfolio of risk-free government securities compared to risky assets moderated interest income, particularly as average yields on government securities declined in 2018 in line with the change in the government's lending strategy.

Interest expense in the period also spiked to ₦373.3 million (FY2017: ₦60.9 million) largely on account of growth in the Bank's funding base (particularly customer deposits). About ₦1.1 million was charged off income as expected credit loss (ECL) impairment charge on loans & advances and off-balance sheet engagements in line with IFRS 9 standards. Overall, net revenue from funds (NRFF) amounted to ₦1.5 billion, 29.1% higher than the prior year. However, Net Interest Spread[1] (NIS) weakened to 80.1% from 95% in 2017 and mirrored the impact of lower yields on the investment portfolio as well as higher funding costs. At this level, NovaMBL's NIS was still higher than Coronation Merchant Bank Limited's ("CoronationMB") NIS of 28.8% and the banking industry's estimated average of 65.4% in the same year. Going into 2019, we expect the Bank's NIS to decline on the back of anticipated increase in government borrowings which would raise funding costs. More so, the merchant banking license makes the Bank highly dependent on wholesale funding.

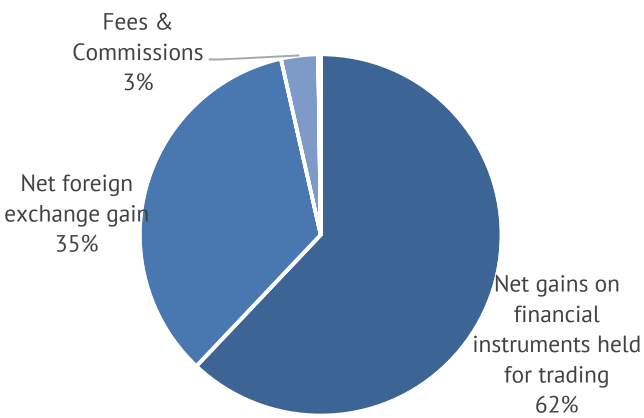
Figure 4: Net Interest Spread



[1] *Net Interest Spread is net interest income expressed as a percentage of interest income*

Supporting NovaMBL's earnings during the period was income from ancillary activities- largely treasury related - which gave rise to non-interest income of ₦878.9 million. Approximately 62% of non-interest income originated from trading activities while foreign exchange gains (comprising foreign currency revaluation gains and foreign currency income) accounted for 35%. Fees & commissions (predominantly credit related fees and account maintenance charges) made up the balance of 3%. We anticipate sustained income in the Bank's trading income in 2019 given persistent volatilities in the fixed income market. NovaMBL's foreign exchange gains were largely as a result of a swap transaction consummated with a client during the period which was a one-off. The sustenance of this income line is dependent on the consummation of similar transactions in the short term. NovaMBL is expanding its foreign banking relationships to provide a foundation on which the Bank can offer foreign currency services to clients. Overall, we consider Nova Merchant Bank's non-interest income to be sustainable and we envisage that it will be a major income source in the near term as the Bank leverages its merchant banking license to offer asset management, wealth advisory, securities trading and other non-banking services. However, NovaMBL will need to aggressively position itself through competence and networking to be successful in these highly competitive spaces.

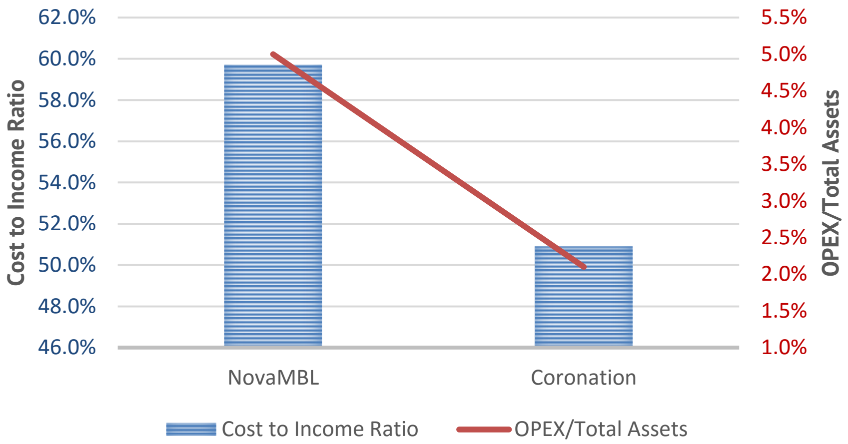
Figure 5: Nova's Non-Interest Income (FY2018)



In the financial period ended 31 December 2018, NovaMBL's operating expenses (OPEX) almost doubled to ₦1.4 billion (FY2017: ₦743.4 million). This spike mirrored a full year operation in 2018 (as against an eight-month period in 2017) as well as start-up costs associated with a new business (recruitments at senior levels to head various departments, depreciation on newly acquired assets, and other related expenses). Staff costs rose by 126.7% to ₦453.3 million on account of staff numbers doubling and accounted for 31.9% of the Bank's total operating expenses. 'Other operating expenses' which largely comprised directors' emoluments & expenses, subscription expenses, 'other license fees' and administrative expenses increased by 54.4% year on year in 2018. NovaMBL's operating expenses as a percentage of net earnings (cost to income ratio) stood at 59.7%, notably lower than 63.9% recorded in 2017, but higher than Coronation Merchant Bank's CIR of 50.9%.

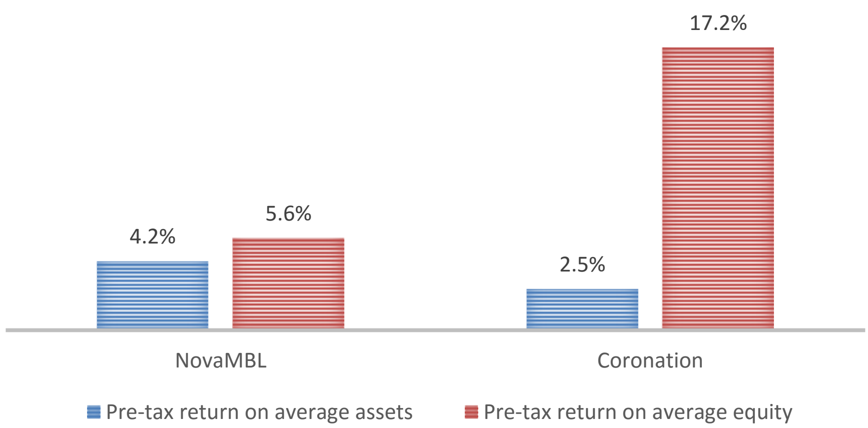
While we acknowledge that significant growth in NovaMBL's cost profile in 2018 was largely driven by start-up costs, we expect a continued upward trajectory in the Bank's OPEX (though moderated) in the short term on account of regulatory mandates such as NDIC premium payments, expansion plans into asset management & securities as well as inflationary pressures. Nonetheless, anticipated rise in net earnings should moderate the Bank's CIR. Management projects a CIR of about 25% in 2019 on the back of better earnings. We consider this to be ambitious, given that the average CIR for merchant banks in 2017 was 53.1%.

Figure 6: Efficiency Ratios (FY2018)



Nova Merchant Bank's profitability rose year on year, recording a pre-tax profit of ₦960.6 million in the 2018, against ₦420.2 million in 2017. Profitability ratios, pre-tax return on average assets (ROA) and a pre-tax return on average equity (ROE) stood at 4.2% and 5.6% respectively. However, NovaMBL's ROE was significantly below Coronation's 17.2% and the average yield of a 365-day treasury certificate which stood at circa 14% in 2018. In our opinion, Nova Merchant Bank's profitability is weak which is expected for a new bank with minimal track record.

Figure 7: Profitability Ratios (FY2018)



Nonetheless, as NovaMBL settles into the merchant banking role, we expect it to take advantage of its lean structure to moderate pressure on its bottom line. According to the 2019 budget available to Agusto & Co during the rating exercise, a pre-tax profit of ₦5 billion is projected with a return on equity of 22.5%. Though achievable, we are cautiously optimistic, given that the country recently concluded an electioneering process and clarity on economic direction and policies may take some time to reflect in the system.

Capital Adequacy

As at 31 December 2018, Nova Merchant Bank's Tier I (core) capital stood at ₦17.6 billion, 6.7% above the prior year's position. Growth was driven by increased retained earnings during the period. Tier 1 capital made up 100% of adjusted capital (as the Bank had no tier II capital), above the regulatory minimum of 75% for merchant banks operating in Nigeria. Tier 1 capital as a percentage of risk weighted assets stood high at 228.64%.

NovaMBL's capitalisation ratios were strong during the review period with a Basel II capital adequacy ratio (CAR) of 228.64%, comfortably above the regulatory threshold of 10% as prescribed by the Central Bank of Nigeria for merchant banks. We note however that this ratio is expected to moderate as the Bank cautiously deploys its capital to creating risk assets which is its core function. Nonetheless, we expect the Bank's capitalisation to remain within comfortable territories in the near term.

Liquidity and Liability Generation

As a licensed merchant bank in Nigeria, NovaMBL is not permitted to engage in retail funding. Furthermore, the merchant banking license allows for wholesale deposits only at a minimum of ₦50 million per tranche. These regulatory restrictions have implications on merchant banks' funding costs, given that wholesale deposits are typically costly, unstable and susceptible to interest rate volatilities. As a result, merchant banks typically record higher cost of funds compared to its commercial banking counterparts.

Nova Merchant Bank Limited has a five-year (2018-2022) funding plan, which is expected to guide its liquidity and liability generation in the short to medium term. The funding plan includes the use of customer deposits, interbank takings, repurchase agreements, commercial papers, corporate bonds and funds from development finance institutions (DFI) over the five-year period to ensure a stable funding base. In addition, Nova Merchant Bank is in the process of setting up an asset management subsidiary targeted at garnering retail type deposits from high net worth individuals (HNIs) as part of its funding strategy in the short term.

In 2018, Nova Merchant Bank Limited commenced deposit liabilities generation and grew customer deposits from a nil position in 2017 to circa ₦6.5 billion. These naira denominated deposits were generated from medium sized corporates, financial institutions and high net worth individuals. The Bank had no interbank takings during the period. Top 20 depositors accounted for 86.9% of total deposits as at 31 December 2018 and a single customer contributed 34.3% to total deposits, reflecting concentration in the Bank's funding base.

Subsequent to the 2018FY, NovaMBL's customer deposits further grew by about 57% to ₦10.2 billion as at February 2019.

NovaMBL's deposit liabilities, which funded 22.9% of total assets & contingents comprised demand deposits (23%) and term deposits (77%) as at FYE2018. The 77:23 split of term to demand deposits showed some deviation from the Bank's initial 50:50 target. In 2019, Nova Bank revised the target to a more realistic ratio of 70:30. To achieve this, NovaMBL intends to leverage the CBN's pre-funding requirements for customers seeking to bid for foreign currency from the apex bank to grow current account balances. NovaMBL's deposit mix in 2018 resulted in a weighted average cost of funds (WACF) of circa 10% which further increased to 10.6% in January 2019. The Bank projects a WACF of 11.5% by end of 2019 which we consider to be conservative.

Figure 8: Customer Deposits by Type (FY2018)

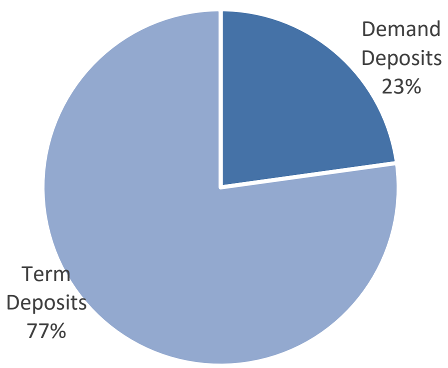
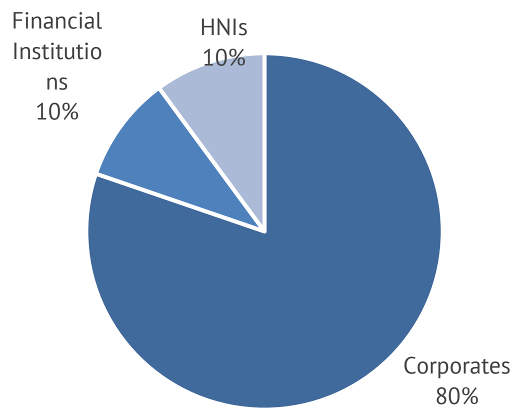


Figure 9: Customer Deposits by Source (FYE2018)



Funding the Bank's operations in 2018 were short term borrowings of ₦1.4 billion from shareholders granted at the commencement of the business in 2017 while the Bank's capital was held with the CBN. These funds, deployed for administrative purposes (including rent) were fully repaid in May 2018.

NovaMBL's liquidity profile was strong during the review period, upheld by a large portfolio of government securities and bank placements. As at 31 December 2018, liquid assets amounted to ₦18.2 billion and accounted for 281.1% of total local currency deposits. At this level, NovaMBL's liquidity ratio stood well above the regulatory threshold of 20% for merchant banks operating in Nigeria. In the short term, liquid assets will be deployed to generate short term funding for risk assets creation through repurchase (REPO) agreements at the interbank market.

In our opinion, Nova Merchant Bank Limited has a strong liquidity profile and its ability to generate deposits is satisfactory. In the short term, the Bank's deposit mobilization is targeted at Pension Fund Administrators (PFAs) and similar institutions, including corporates and HNIs. The Bank's net loans as a percentage of deposits of a negative 203.9% reflects ample room for loan growth in the near term. We expect this percentage to moderate as the Bank grows its loan portfolio.

OWNERSHIP, MANAGEMENT & STAFF

Nova Merchant Bank Limited is privately owned by institutional & individual investors within and outside Nigeria. According to the register of shareholders as at 31 December 2018, the following held more than 5% of the Bank's issued share capital.

Table 4: Major Shareholders as at 31 December 2018

Shareholders	Shareholding ('000)	% Holding
Afriglobal Investment Holding	1,980,250	12.377%
Five Star Associate Limited	1,980,250	12.377%
Carbon Commodities DMCC	3,960,500	24.753%
Phillips Oduoza	8,079,000	50.493%*
Total	**16,000,000**	**100.000%**

**Direct and indirect shareholdings*

NovaMBL is governed by an eight-member Board of Directors which is chaired by Mr. Phillips Oduoza. The Board comprises two Executive Directors and six Non-Executive Directors (four of whom are Independent Directors). During the 2018 financial year, Mr. Chinedu Ikwudinma (pioneer Managing Director/CEO) disengaged from the Board effective 30 August 2018 and Mr. Anya Duroha was appointed substantive Managing Director/CEO effective 31 August 2018 and his appointment was confirmed on 1 January 2019. He is supported by a management team of seven people.

Phillips Oduoza is the founder and Chairman of the Board of Nova Merchant Bank Limited with about 30 years banking experience in major financial institutions. Prior to promoting NovaMBL, he was the Group Chief Executive Officer of UBA Group Plc. Mr. Oduoza was part of the team that pioneered and established Diamond Bank Plc in the early 90s. Mr. Phillips Oduoza has served on the Board of key institutions such as Diamond Bank Plc, Interswitch Plc, Valuecard Plc (Unified Payment Services Plc), Nigeria Interbank Settlement System (NIBSS), Nigeria Payment System, Nigeria Economic Summit Group (NESG), Financial Markets and Dealers Quotation (FMDQ), UBA Capital and UBA Plc. He currently serves on the Board of Veritas University Abuja, Lagos State Security Trust Fund and Development Bank of Nigeria (DBN).

In the period under review, Nova Merchant Bank employed an average of 42 persons. This was a significant jump from 21 persons employed in the prior year as major recruitment were made across management and non-management levels, being a new bank. Management staff accounted for 57% of the Bank's staff strength while non-management staff made up the balance of 43%. Concurrently, staff cost spiked to ₦453.3 million in 2018 (FY2017: ₦200 million), largely reflecting recruitments at senior levels to head various departments of the Bank. Staff productivity, measured as net earnings per staff increased marginally to ₦56.7 million and covered staff cost per employee 5.3 times, above the estimated banking industry average of 4.7 times but below Coronation Merchant Bank's 7.4 times.

We consider NovaMBL's management team to be experienced and staff productivity to be good. However, the stability of the management team is vital to sustaining overall success of the Bank.

MARKET SHARE

The merchant banking segment of the banking industry is expanding, with five licensed players in operations as at FYE2018, from a nil position in 2012. Nonetheless, the segment accounts for less than 2% of the banking industry's total assets & contingents. Although we expect this percentage to increase in the near term, we believe that merchant banks will continue to face intense competition from commercial banks and boutique investment companies. Our view is driven by restrictions on merchant banking operations imposed by regulation and minimal knowledge on the segment's operations by the Nigerian populace. Nonetheless, we believe that NovaMBL can capitalise on its competitive advantages such as its experienced management team and technology driven strategy to grow market share in the near term.

Nova Merchant Bank Limited is the newest entrant into the Nigerian merchant banking space. Although the Bank grew its asset base considerably in 2018, its balance sheet remains the smallest of the five licensed operators. According to Agusto & Co's estimates for the banking industry in 2018, Nova Merchant Bank Limited held 0.07% of the Industry's assets & contingents. The Bank's share of the Industry's local currency (LCY) deposits (excluding interbank takings) stood at 0.04% as at FYE2018 from a nil position in 2017. NovaMBL also held 0.02% of the banking industry's net loans and 0.09% of pre-tax profits in 2018.

Although NovaMBL's market share across key indicators is low, we expect its business expansion plans to translate to higher market share of the Industry's resources in the near term as well as a stronger footing in the merchant banking space.

OUTLOOK

As a late entrant into a highly competitive industry going through a difficult macroeconomic period, NovaMBL intends to differentiate itself by focusing on its discriminating competencies in problem solving, innovative disruption and digital banking to gain momentum. The Bank is also adopting pricing as a penetration strategy to win market share from commercial banks, targeting corporate accounts held by a few Tier 2 banks.

In the short term however, NovaMBL is scaling the business by building on the benefits of its first year in operations to:

- increase the Bank's funding base by:
  - issuing commercial papers
  - leveraging securitization/swaps in the money market
- improve customer experience via partnerships with financial technology (Fintech) companies
- automate existing manual processes
- scale up employee skills

On the back of a stronger funding base, Nova Merchant Bank projects an asset base of ₦78.9 billion and a loan book of ₦25 billion by end of the 2019 financial year. We consider these achievable. However, we remain cautiously optimistic given the fragile state of the economy and weak investor sentiments elicited by macroeconomic uncertainties. We view positively, ongoing plans to set up an asset management subsidiary to drive the Bank's funding base. Activities in the investment banking segment are also expected to increase as the Nigerian economy opens up. We foresee mergers & acquisitions (M&As), as well as debt raising exercises by companies across various sectors in the Nigerian economy. These present opportunities for merchant banks to increase non-interest income and deepen footprints in the Nigerian financial sector. However, NovaMBL would need to position itself aggressively by acquiring necessary competencies and network to take advantage of the opportunities given that these are highly competitive segments of the financial market.

Going forward, we expect NovaMBL's capital to remain good and asset quality, acceptable. The Bank's cost profile is expected to remain elevated as it expands.

We 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-18		31-Dec-2017	
		₦'000		₦'000	
	ASSETS				
1	Cash & equivalents			1,224,514	6.8%
2	Government securities	14,243,090	50.4%	16,000,000	88.9%
3	Money Market Placements	3,883,786	13.7%		
4	Quoted investments				
5	Placements with discount houses				
6	LIQUID ASSETS	18,126,876	64.1%	17,224,514	95.7%
7	BALANCES WITH NIGERIAN BANKS	131,941	0.5%		
8	BALANCES WITH BANKS OUTSIDE NIGERIA	1,063,853	3.8%		
9	Direct loans and advances - Gross	2,428,797	8.6%		
10	Less: Cumulative loan loss provision	(980)	0.0%		
11	Direct loans & advances - net	2,427,817	8.6%		
12	Advances under finance leases - net				
13	TOTAL LOANS & LEASES - NET	2,427,817	8.6%		
14	INTEREST RECEIVABLE				
15	OTHER ASSETS	1,000,336	3.5%	332,826	1.8%
16	DEFERRED LOSSES	294,497	1.0%	94,497	0.5%
17	RESTRICTED FUNDS				
18	UNCONSOLIDATED SUBSIDIARIES & ASSOCIATES				
19	OTHER LONG-TERM INVESTMENTS			23,163	0.1%
20	FIXED ASSETS & INTANGIBLES	1,940,819	6.9%	316,750	1.8%
21	**TOTAL ASSETS**	**24,986,139**	**88.4%**	**17,991,750**	**100.0%**
22	TOTAL CONTINGENT ASSETS	3,281,426	11.6%		
23	**TOTAL ASSETS & CONTINGENTS**	**28,267,565**	**100%**	**17,991,750**	**100%**
	CAPITAL & LIABILITIES				
24	TIER 1 CAPITAL (CORE CAPITAL)	17,611,431	62.3%	16,510,576	91.8%
25	TIER 2 CAPITAL				
26	MEDIUM TERM BORROWINGS			1,435,761	8.0%
27	Demand deposits	1,481,449	5.2%		
28	Savings deposits				
29	Time deposits	5,013,024	17.7%		
30	Inter-bank takings				
31	TOTAL DEPOSIT LIABILITIES - LCY	6,494,473	23.0%		
32	Customers' foreign currency balances				
33	TOTAL DEPOSIT LIABILITIES	6,494,473	23.0%		
34	INTEREST PAYABLE				
35	OTHER LIABILITIES	880,235	3.1%	45,413	0.3%
36	**TOTAL CAPITAL & LIABILITIES**	**24,986,139**	**88.4%**	**17,991,750**	**100.0%**
37	TOTAL CONTINGENT LIABILITIES	3,281,426	11.6%		
38	**TOTAL CAPITAL, LIABILITIES & CONTINGENTS**	**28,267,565**	**100%**	**17,991,750**	**100%**
	BREAKDOWN OF CONTINGENTS				
39	Acceptances & direct credit substitutes	3,115,216	11.0%		
40	Guarantees, bonds etc..	116,210	0.4%		
41	Short-term self liquidating contingencies	50,000	0.2%		

NOVA MERCHANT BANK LIMITED

	STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED	31-Dec-18		31-Dec-2017	
		₦'000		₦'000	
42	Interest income	1,876,519	68.1%	1,224,514	100.0%
43	Interest expense	(373,347)	-13.5%	(60,878)	-5.0%
44	Loan loss expense	(1,148)	0.0%		
45	NET REVENUE FROM FUNDS	1,502,024	54.5%	1,163,636	95.0%
46	ALL OTHER INCOME	878,949	31.9%		
47	**NET EARNINGS**	**2,380,973**	**86.4%**	**1,163,636**	**95.0%**
48	Staff costs	(453,315)	-16.5%	(200,008)	-16.3%
49	Depreciation expense	(145,293)	-5.3%	(11,118)	-0.9%
50	Other operating expenses	(821,774)	-29.8%	(532,270)	-43.5%
51	TOTAL OPERATING EXPENSES	(1,420,382)	-51.5%	(743,396)	-60.7%
52	PROFIT (LOSS) BEFORE TAXATION	960,591	34.9%	420,240	34.3%
53	TAX (EXPENSE) BENEFIT	190,394	6.9%	90,336	7.4%
54	**PROFIT (LOSS) AFTER TAXATION**	**1,150,985**	**41.8%**	**510,576**	**41.7%**
55	NON-OPERATING INCOME (EXPENSE) - NET				
56	DIVIDEND				
57	**GROSS EARNINGS**	**2,755,468**	**100%**	**1,224,514**	**100%**
58	AUDITORS	PWC		PWC	
59	OPINION	CLEAN		CLEAN	

	KEY RATIOS	31-Dec-18	31-Dec-2017
	EARNINGS		
60	Net interest margin	80.1%	95.0%
61	Loan loss expense/Interest income	0.1%	
62	Return on average assets & contingents (Pre - tax)	4.2%	7.0%
63	Return on average equity (Pre - tax)	5.6%	7.6%
64	Operating Expenses/Net earnings	59.7%	63.9%
65	Gross earnings/Total assets & contingents (average)	11.9%	13.6%
	EARNINGS MIX		
66	Net revenue from funds	63.1%	100.0%
67	All other income	36.9%	
	LIQUIDITY		
68	Total loans & leases - net/Total lcy deposits	-203.9%	Nil
69	Liquid assets/Total lcy deposits	281.1%	Nil
70	Demand deposits/Total lcy deposits	22.8%	Nil
71	Savings deposits/Total lcy deposits	Nil	Nil
72	Time deposits/Total lcy deposits	77.2%	Nil
73	Inter-bank borrowings/Total lcy deposits		Nil
74	Interest expense - banks/Interest expense		
75	**NET FOREIGN CURRENCY ASSETS (LIABILITIES)**	Nil	Nil

NOVA MERCHANT BANK LIMITED

	KEY RATIOS CONT'D	31-Dec-18	31-Dec-2017
	ASSET QUALITY		
76	Performing loans (₦'000)	2,428,797	
77	Non-performing loans (₦'000)	Nil	Nil
78	Non-performing loans/Total loans - Gross	Nil	Nil
79	Loan loss provision/Total loans - Gross	0.0%	
80	Loan loss provision/Non-performing loans	Nil	Nil
81	Risk-weighted assets/Total assets & contingents	28.8%	3.6%
	CAPITAL ADEQUACY		
82	Adjusted capital/risk weighted assets (Basel I)	204%	2539%
83	Tier 1 capital/Adjusted capital	100%	100%
84	Total loans (net)/Adjusted capital	0.15	
85	Capital unimpaired by losses (₦'000)	17,316,934	16,416,079
	STAFF INFORMATION		
86	Net earnings per staff (₦'000)	56,690	55,411
87	Staff cost per employee (₦'000)	10,793	9,524
88	Staff costs/Operating expenses	31.9%	26.9%
89	Average number of employees	42	21
90	Average staff per office	42	21
	OTHER KEY INFORMATION		
91	Legal lending limit(₦'000)	8,658,467	8,208,040
92	Other unamortised losses(₦'000)	NONE	NONE
93	Unreconciled inter-branch items (₦'000) DR/(CR)	NONE	NONE
94	Number of offices	1	1
95	Age (in years)	1	1
96	Government stake in equity (Indirect)	-	-
	MARKET SHARE OF INDUSTRY TOTAL	**Estimate**	**Actual**
97	Lcy deposits (excluding interbank takings)	0.0%	
98	Total assets & contingents	0.1%	0.1%
99	Total loans & leases - net	0.0%	
100	Non interest income	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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