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Nova Merchant Bank Limited

Nigeria Bank Analysis **April 2019**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long-term	National	BBB-(NG)	Stable	March 2020
Short-term	National	A3(NG)		

Financial data:

(USDm comparative) ǂ

	31/12/18
NGN/USD (avg.)	305.6
NGN/USD (close)	306.5
Total assets	81.5
Primary capital	57.5
Net advances	7.9
Liquid assets	29.1
Operating income	7.8
Profit after tax	3.8
Market cap.*	n.a.
Market share*	n.a.

ǂCentral Bank of Nigeria ("CBN") exchange rates

Rating history:

Initial/ last Rating (April 2019)
Long-term rating: BBB-(NG)
Short-term rating: A3(NG)
Rating outlook: Stable

Related methodologies/research:

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2017

Glossary of Terms/Ratios, February 2016

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Summary rating rationale

- The ratings accorded to Nova Merchant Bank Limited ("Nova" or "the bank") reflect its nascence status, with limited track record of less than two years. Accordingly, the ratings are based on Global Credit Rating Company Limited's evaluation of Nova's strategic plan, profile of owners and management, as well as financial performance so far. Specifically, the accorded ratings are presently constrained by the prevailing fierce competition in the Nigerian banking space, which could make market penetration difficult for a new entrant.
- The profile of the members of Nova's board of directors ("the board") and management team is considered strong in terms of experience in the Nigerian banking industry.
- Nova's capitalisation is considered satisfactory relative to its current risk level. Total shareholders' funds stood at N17.6bn at FY18, translating to a risk weighted capital adequacy ratio ("RWCAR") of 228.7%, compared to the 10% statutory minimum requirement. This reflects the bank's nascent status, with insignificant loan exposures at the year end.
- Liquidity risk appears low based on Nova's balance sheet structure at FY18, with cash and liquid assets (including held to maturity investment securities) comprising a notable 72.6% of the bank's asset base. Furthermore, the matching of the bank's assets and liabilities maturities at the balance sheet date shows liquidity buffer across all maturity bands, with cumulative liquidity buffer amounting to N10.8bn at FY18. Nevertheless, the short maturity profile of the deposit book, coupled with the concentrated nature of the deposit base at present is a rating constraining factor.
- While non-performing loan was nil at FY18, cognisance must be taken of the fact that the bank commenced lending activity towards the end of the year, as well as the short-dated nature of the exposures.
- As a new entrant, Nova experienced deposit mobilisation challenge in early part of FY18, consequently constraining its asset creation capacity. Thus, operating income ended 53.6% below forecast at N2.4bn, with revenue significantly supported by treasury activities. The delay in the implementation of certain initiatives (including information technology platform) planned for the year saw operating expenses end at 49.2% of forecast, translating to a lower cost ratio of 59.6% (compared to the projected 64.9%). Overall, Nova recorded a pre-tax profit of N960.6m for FY18, representing 77.1% of forecast.

Factors that could trigger a rating action may include

Positive change: Successful implementation of the bank's strategic plan, with evident record of satisfactory improvement in competitive position, established and sustained track record (capitalisation, profitability and asset quality).

Negative change: Inability of management to successfully execute the unveiled strategic plan, sustained weak competitive position, as well as pressure on performance metrics (financial, capitalisation, asset quality, and liquidity metrics).

Organisational profile

Corporate summary

Nova was incorporated on 17 May 2017 and commenced operations on 01 February 2018, focusing on merchant banking activities such as corporate banking and money market activities (including holding and trading of marketable securities).

Ownership structure

Nova's ownership base comprised one individual and three institutional investors. The individual investor (also the chairman of the board) owns 50.49% (direct and indirect holding) of the bank's issued shares as at 31 March 2019. Table 1 shows the ownership structure of the bank at that date.

Table 1: Shareholding structure at 31 March 2019	% holding
Afriglobal Investment Holding	12.38
Five Star Associate Limited	12.38
Carbon Commodities DMCC	24.75
Phillips Oduoza (direct and indirect holding)	50.49
Total	**100.00**

Source: Nova

Strategy and operations

Nova is currently at the initial phase of its five year strategic plan. The strategic plan (spanning 2018-2022) is broken down into four phases. The first phase, tagged 'Generate Momentum', is the start-up phase and focused on capacity building (including human, information technology, as well as strategic partnership with other financial institutions). The second phase, tagged 'Scale the Business', is focused on market penetration through asset and liability product development, and scale-up of employees' skill. Third and fourth phases are focused on market share scale-up.

In line with its current business scale, Nova has adopted a simple operational structure, having two market facing strategic business units (Investment Banking Unit and Wholesale Banking Unit) and Treasury, all reporting directly to the Managing Director ("MD")/Chief Executive Officer ("CEO"). Other support services (such as information technology, operations, internal control, finance, compliance corporate services human capital management and communication, marketing and branding) report to the Chief Operating Officer. While the head of the strategy unit reports directly to the CEO, both the heads of the risk management and the internal audit unit have dual reporting line (reporting directly to the board with a dotted reporting line to the CEO).

Nova's operations are supported by the 'Intellect Design Arena Core Banking System', designed by Intellect Arena Design Limited (an India based company). The IT system is considered suitable for the bank's operation based on its scalability and robustness, and end–to-end features.

Governance structure

Nova's corporate governance structure (in terms of board's composition) is considered satisfactory based on statutory requirement and the bank's present operational scale. Six out of the eight member board (including the Chairman) are non-executive directors and the roles of the Chairman and the MD are distinct and clearly defined, with the former not involved in the day to day running of the bank. Furthermore, four of the non-executive directors are designated as independent. Overall, the profile of the members of the board in terms of professional background and experience is considered strong. Board's oversights are shared among four standing committees namely: the Board Risk Management and Audit Committee, the Board Finance and General Purpose Committee, the Board Nomination and Governance Committee, and the Board Credit and Investment Committee.

Management

The management team is presently led by Mr. Anya Duroha, who replaced the pioneer MD (Mr. Chinedu Ikwudinma). According to management, the pioneer MD, hired with a mandate to set up the bank and implement its short term plan, disengaged after serving for a year and three months based on mutual agreement with the bank.

The profile of the incumbent MD is considered strong based on his professional qualifications and experience, possessing over 25 years' banking experience. He is supported by an executive director and six other management staff. Nova had 42 full-time employees as at end march 2019.

Financial reporting

Nova's financial statements for the year ended 31 December 2018 were prepared in accordance with International Financial Reporting Standards ("IFRS"), provisions of the Companies and Allied Matters Act, Banks and Other Financial Institutions Act and the Financial Reporting Council of Nigeria requirements. The bank's external auditor, PricewaterhouseCoopers Chartered Accountants, issued an unqualified opinion on the financial statements.

Operating environment

Economic overview

The Nigerian economy witnessed sustained economic growth in 2018, albeit characterised by mixed growth trajectory. While growth in the first half of the year was somewhat sluggish due to contractions in the oil sector (on the back of declined domestic oil production and volatility in global crude oil prices), delayed passage and implementation of the budget amongst other factors. However, performance was firmer in the second half, propelled by a combination of increased government investment on capital projects and the improved performance of the non-oil sector, ultimately accelerating the full year economic growth rate. Specifically, the non-oil sector grew by

2.7% in 2018 compared to 1.5% in 2017, while the oil sector grew moderately by 1.1% (2017: 4.7%). Overall, the real GDP expanded by 1.9% year-on-year up from 0.8% registered in 2017[1].

The real GDP growth is projected at 2.0% and 2.2% by the International Monetary Fund and World Bank respectively for 2019. This is expected to be underpinned by recovery in global crude oil price amidst agreed global production cut by Organisation of Petroleum Exporting Countries and its allies, as well as sustained implementation of the Economic Recovery and Growth Plan (2017–2020) by the government. Anticipated drawbacks to these projections include; perceived political risks associated with the 2019 general elections and persistent security challenges arising from insurgency in the North East and herdsmen attack in some parts of the country. Also, the anticipated upward review of the national minimum wage (currently at N18, 000) and other social intervention programs by the government could exacerbate inflationary pressures in 2019. To curtail this effect, CBN is expected to engage in a frequent Open Market Operation ("OMO") auctions and maintain tight monetary policies.

Foreign exchange ("FX") remained relatively stable in 2018 at an average rate of N305.6/USD and N364/USD at the official and parallel market respectively on account of various CBN's FX interventions aimed at easing pressure on Naira. Furthermore, CBN maintained a non-expansionary monetary policy stance by leaving the benchmark monetary policy rate, the liquidity ratio and cash reserve ratio unchanged at 14%, 30% and 22.5% respectively throughout 2018 to contain inflationary pressures. To this end, the headline inflation declined progressively from 15.1% in January to close at 11.4% in December 2018, albeit measured above the targeted single digit rate by CBN for the period.

After being adjudged the global third best performing stock market in 2017 with a strong growth of 42.3%, The Nigerian Stock Exchange recorded 17.8% contractions in the All Share Index to close at 31430.50 points in 2018. Similarly, market capitalization dipped by 13.9% to N11.7tn. This deterioration can be attributed to pre-election jitters and heightened capital outflows on the back of attractive yields in the developed economy as well as the tensed trade war between the US and China.

Industry overview

In line with global practice, the Nigeria banking industry commenced full implementation of the IFRS 9 with effect from 1 January 2018, shifting from incurred credit loss model to expected credit loss ("ECL") model, which is a more forward looking approach. To cushion the effect of ECL provisions on capitalisation, CBN introduced a four-year transitional arrangement which requires banks to hold static the adjusted day one impact of IFRS 9 impairment charges and spread it over a four-year period. This, combined with capital raising initiatives employed by a number of banks and strict dividend payment regulations resulted in the rise in the industry's average CAR to 15.3% in December 2018, from 10.2% in December 2017. According to CBN, a new capital rule is expected to be introduced in the first half of 2019, aimed (inter alia) at aligning CAR computation with international regulatory accord (Basel III) as well as ensure banks maintain adequate capital buffer to withstand any acute financial stress scenario.

The industry's profitability for 2018 reflects an improvement, underpinned by margin expansion, declined impairment charge, and growth in digital transaction volume. Total banking sector assets stood at N37.1tn at end-November 2018 (December 2017: N34.6tn), while the credit portfolio decreased by 3.2% to N19.8tn due to the conservative lending approach adopted by most banks. Per CBN's statistics, the industry's average gross NPL ratio declined to 12.5% at 1H 2018 (December 2017: 14.8%), albeit remaining above the regulatory threshold of 5%. The decrease can be attributed to the favourable macroeconomic conditions and stricter prudential regulations.

In a bid to bolster economic growth and facilitate credit financing to the real sector (particularly the Agriculture and Manufacturing sector) at a single digit rate of 9%, CBN in August 2018 introduced the Differentiated Cash Reserve Requirement ("DCRR") programme. Under this programme, banks are given access to restricted deposits held with the apex bank as cash reserve requirement ("CRR") to finance CBN's approved projects in the real sector.

The evolvement of financial technology companies ("fintech") and other non-bank companies leveraging technology (in provision of financial services) has intensified competitive pressure in the Nigerian banking sector, particularly in the retail banking space. The competitive dynamics was further intensified by the decision of CBN in October 2018 to licence the Payment Service Banks ("PSBs"). The decision was premised on the apex bank's objective to enhance financial inclusion and stimulate economic activities in the rural and unbanked areas by leveraging on existing facilities of the telecommunication companies and other companies' predominantly in areas with limited banking presence and ultimately achieve 80% financial inclusion target by year-end 2020.

As at 31 December 2018, Nigeria's financial services sector comprised 21 commercial banks, five merchant banks, one non-interest bank, and over 4,000 other non-bank financial institutions. The commercial

[1] National Bureau of Statistics, Nigeria.

banking subsector comprised eight international banks, eleven national banks, and two regional banks. Polaris Bank Limited, the only bridged bank under the control of Asset Management Corporation of Nigeria ("AMCON") was established in September 2018 following the assumption of the asset and liabilities of the defunct Skye Bank Plc by CBN. More recently (March 2019) the industry witnessed a merger between two commercial banks; Access Bank Plc and Diamond Bank Plc, This is expected to alter the competitive position of the players in the commercial banking space.

Competitive position (merchant banks)
Nova is the fifth and latest entrant into the Nigerian merchant banking space. Nova is unique somewhat relative its predecessors based on operational background and/ or ownership structure. Specifically, three of its peers have discount house background, while two (including one in the aforesaid category) are subsidiaries of other financial institutions. Table 2 highlights the status of the merchant banks in Nigeria.

Table 2: Categories of merchant banks in Nigeria	Discount house background	Subsidiary of other financial institutions
Coronation Merchant Bank Limited	Yes	No
FBN Quest Merchant Bank Limited	Yes	Yes
FSDH Merchant Bank Limited	Yes	No
Nova Merchant bank Limited	No	No
Rand Merchant bank Limited	No	Yes

A meaningful peer comparison based on up-to-date financial performance is not currently possible, as most of the banks have yet to publish their 2018 audited financial statements, besides the newness of Nova relative to its peers. However, Nova appears competitively disadvantaged by its newness and absence of parental support presently.

Financial profile

Likelihood of support
State support (in terms of bailout) appears unlikely for merchant banks in Nigeria, all being private companies. Thus, available financial support for Nova (as with its peers) is limited to capital injection by its shareholders.

Funding composition
Merchant banks in Nigeria are funded through customer deposits, equity capital and borrowings. Nova's funding base comprised equity capital (74.4%) and customer deposits (25.6%) at FY18.

Customer deposits
Customer deposits stood at N6.1bn at FY18. Being at a take-off stage, Nova's deposit book is relatively concentrated, with the single and five largest deposits comprising 36.5% and 62.7% of the deposit base at FY18. The maturity profile of the liability pool is short, with 24.4% and 75.6% of the deposit book maturing within three months and between four to 12 months respectively. Management targets a 5.6 folds growth in deposit in FY19 through roll out of bespoke liability generating products and on the back of improved brand recognition by the market.

Capital structure
Nova's total shareholders' funds stood at N17.6bn at FY18, translating to an exceptionally high RWCAR adequacy of 228.7%, compared to the 10% statutory minimum requirement. This reflects the bank's nascent status, with insignificant loan exposures at the year end. Thus, GCR expects this capitalisation ratio to drastically moderate as the bank's lending activity intensifies in the immediate future. According to management the ratio ended down at 173.7% at end February 2019.

Liquidity positioning
Liquidity risk appears low based on Nova's balance sheet structure at FY18, with cash and liquid assets (including held to maturity investment securities) comprising a notable 72.6% of the asset base. Furthermore, the matching of the bank's assets and liabilities maturities at the balance sheet date shows liquidity buffer across all maturity bands, with cumulative liquidity buffer amounting to N10.8bn at FY18.

Table 3: Liquidity position at FY18 (N'm)	1-3 months	3-12 months
Assets	13,062.5	5,067.9
Liabilities	(2,617.9)	(4,698.8)
Net liquidity gap	**10,444.6**	**369.1**
Cumulative liquidity gap	**10,444.6**	**10,813.7**

Source: Nova AFS

Operational profile

Risk management
Nova's risk management framework appears to be robust, covering key risk areas, such as operational risk, credit risk, market risk, reputational risk, legal risk, as environmental and social risk However, the effectiveness of the framework is yet to be fully tested, given the bank's short track record.

Asset composition
Nova's balance sheet at FY18 was highly liquid. Total assets stood at N24.9bn, with cash and liquid assets (excluding held-to-maturity securities) constituting 35.7% of the asset base. Highly liquid investment securities (treasury bills held to maturity) comprised additional 36.9% of the asset base, with higher risk asset portfolio (loans and advances) representing just 9.7% of the asset base.

Table 4: Asset mix	FY18 (N'm)	%
Cash & liquid assets	**8,908.0**	**35.7**
Balances with CBN	-	-
Balances with other financial inst.	*5,079.6*	*20.3*
Financial assets held for trading	*3,828.4*	*15.3*
Investments securities	9,222.4	*36.9*
Customer advances	2,427.8	9.7
Property, plant and equipment	1,213.3	4.9
Pledged assets	1,192.3	4.8
Other assets	2,022.4	8.1
Total	**24,986.2**	**100.0**

Source: Nova

Contingencies

Contingent assets stood at N3.3bn, representing 18.6% of capital at FY18. The portfolio comprised Letters of credit (95.0%), bonds and guarantees (3.5%), and loan commitments (1.5%).

Loan portfolio

Gross loans and advances stood at N2.4bn at FY18. The loan book reflects the bank's emerging status with regards to loan concentration, with the loan book made up of two obligors at FY18. The maturity profile of the loan book is short, with the exposures maturing within three months. Management has budgeted an 11.6 folds growth in loans and advances in FY19, with emphasis on high quality obligors.

Foreign currency exposure

Nova is exposed to foreign exchange risks through its foreign currency denominated borrowings, deposits and advances. However, this risk has been largely mitigated through matching of related assets/liabilities. Table 5 indicates that Nova's exposure to foreign exchange risk is low at FY18.

Table 5: Net FCY position at FY18 (N'm)	USD	Euro	Total
Financial assets	2,579.9	47.2	2,627.1
Financial liabilities	(704.4)	(47.2)	(751.6)
Net assets/(liabilities)	**1,875.5**	**-**	**1,875.5**

Source: Nova

Asset quality

Inasmuch as non-performing loan was nil at FY18, cognisance must be taken of the fact that the bank commenced lending activity towards the end the year and the short-dated nature of the exposures.

Financial performance

A one year and eight months financial synopsis is reflected on page seven of this report, supplemented by the commentary below.

As a new entrant, Nova experienced deposit mobilisation challenge in early part of FY18, consequently constraining its asset creation capacity. Thus, operating income ended 53.6% below forecast at N2.4bn, with revenue significantly supported by treasury activities. The delay in the implementation of certain initiatives (including information technology platform) planned for the year saw operating expenses end at 49.2% of forecast, translating to a lower cost ratio of 59.6% (compared to the projected 64.9%). Overall, Nova recorded a pre-tax profit of N960.6m for FY18, representing 77.1% of forecast.

While Nova has made notable progress in the implementation of the first phase of its strategic plan, involving deployment and stabilisation of key systems and platforms, securing short term funding and engagement of customers and stakeholders so far, some key initiatives (such as information technology project and funding) planned to be fully executed in FY18 have dragged into the current financial year. Having surmounted the take-off related challenges, management is anticipating a 218.5% growth in total operating income for FY18 based on the anticipated enhanced funding base and ultimately earning assets increase. Operating expenses is expected to rise by a less aggressive 79.7%. Thus, performance at the pre-tax level is expected to improve notably 5.2 times to N5.0bn in FY19.

Table 6: Financial performance (N'm)	Projection FY18	Actual FY18	Budget FY19
Net interest income	3,119.2	1,503.2	4,592.9
Other income	1,327.7	878.9	2,993.3
Total operating income	**4,446.9**	**2,382.1**	**7,586.2**
Impairment charge	(313.9)	(1.1)	(28.2)
Operating expenses	(2,886.5)	(1,420.4)	(2,552.9)
NPBT	**1,246.5**	**960.6**	**5,005.1**
Balance sheet			
Total assets	67,465.0	24,986.1	78,934.7
Loans & advances	25,109.2	2,427.8	28,220.3
Customer deposits	42,685.6	6,066.7	34,000.0
Total capital	17,246.6	17,611.4	22,268.1

Source: Nova

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Nova Merchant Bank Limited

(Naira in millions except as noted)

Year end: 31 December

Statement of Comprehensive Income Analysis	2017*	2018
Interest income	1,224.5	1,876.5
Interest expense	(60.9)	(373.3)
Net interest income	**1,163.6**	**1,503.2**
Other income	-	878.9
Total operating income	**1,163.6**	**2,382.1**
Impairment charge	-	(1.1)
Operating expenditure	(743.4)	(1,420.4)
Net profit before tax	**420.2**	**960.6**
Tax	90.3	190.4
Profit after tax	**510.6**	**1,151.0**
Other comprehensive (loss)/gain	-	(50.1)
Net income	**510.6**	**1,099.9**

Statement of Financial Position Analysis		
Subscribed capital	16,000.0	16,000.0
Reserves (incl. net income for the year)	510.6	1,611.4
Total capital and reserves	**16,510.6**	**17,611.4**
Bank borrowings (incl. deposits, placements & REPOs)	-	427.8
Deposits (incl. REPOs)	-	6,066.7
Other borrowings	-	-
Short-term funding (< 1 year)	**-**	**6,494.5**
Payables/Deferred liabilities	1,481.2	880.2
Other liabilities	**1,481.2**	**880.2**
Total capital and liabilities	**17,991.8**	**24,986.1**
Property, plant and equipments	3.1	1,213.3
Derivative financial assets	-	20.8
Receivables/Deferred assets (incl. zero rate loans)	17,651.8	3,194.0
Non-earnings assets	**17,654.9**	**4,428.0**
Short-term deposits & cash	-	-
Loans & advances (net of provisions)	23.2	2,427.8
Cash and bank placements	-	5,079.6
Marketable and trading securities	313.7	13,050.8
Total earning assets	**336.8**	**20,558.2**
Total assets	**17,991.8**	**24,986.1**

Ratio Analysis (%)		
Capitalisation		
Internal capital generation	3.1	6.3
Total capital / Net advances + net equity invest. + guarantees	n.a.	725.4
Total capital / Total assets	91.8	70.5
Liquidity		
Net advances / Deposits + other short-term funding	n.a.	37.4
Net advances / Total funding (excl. equity portion)	n.a.	37.4
Liquid & trading assets / Total assets	1.7	72.6
Liquid & trading assets / Total short-term funding	n.a.	279.2
Liquid & trading assets / Total funding (excl. equity portion)	n.a.	279.2
Asset quality		
Impaired loans / Gross advances	0.0	0.0
Total loan loss reserves / Gross advances	0.0	0.0
Bad debt charge (income statement) / Gross advances (avg.)	n.a.	0.1
Bad debt charge (income statement) / Total operating income	0.0	0.0
Net charge-off ratio	n.a.	n.a.
Recovery ratio	n.a.	n.a.
Growth in loan loss reserves	n.a.	n.a.
Profitability		
Net income / Total capital (avg.)	6.2	6.5
Net income / Total assets (avg.)	5.7	5.1
Net interest margin	n.a.	14.4
Non-interest income / Total operating income	0.0	36.9
Non-interest income / Total operating expenses (or burden ratio)	0.0	61.9
Cost ratio	63.9	59.6
OEaA (or overhead ratio)	8.3	6.6
ROaE	9.3	6.7
ROaA	8.5	5.4
Nominal growth indicators		
Total assets	n.a.	38.9
Net advances	n.a.	n.a.
Shareholders funds	n.a.	6.7
Total capital and reserves	n.a.	6.7
Deposits (wholesale)	n.a.	n.a.
Total funding (excl. equity portion)	n.a.	n.a.
Net income	n.a.	43.7

*Refers to 8-month period

SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and (d) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

The ratings were solicited by, or on behalf of, Nova Merchant Bank Limited, and therefore, GCR has been compensated for the provision of the ratings.

Nova Merchant Bank Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings above were disclosed to Nova Merchant Bank Limited with no contestation of/changes to the ratings.

The information received from Nova Merchant Bank Limited to accord the credit rating included the latest audited annual financial statements as at 31 December 2018 (plus eight months of comparative numbers), latest internal and/or external audit report to management, full year detailed budgeted financial statements for 2018 and the bank's five year strategic plan. In addition, information specific to the rated entity and/or industry was also received.